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7 UNITED STATES DISTRICT COURT  
8 CENTRAL DISTRICT OF CALIFORNIA  
9

10 SECURITIES AND EXCHANGE ) CASE NO. CV 11-5316-R  
11 COMMISSION, )  
12 )  
13 Plaintiff, ) FINDINGS OF FACT AND  
14 ) CONCLUSIONS OF LAW  
15 v. )  
16 )  
17 PETER L. JENSEN AND THOMAS C. )  
18 TEKULVE, JR., )  
19 )  
20 Defendants. )  
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29 On June 24, 2011 the Securities and Exchange Commission's ("SEC" or "Commission")  
30 filed a complaint ("Complaint") against Peter L. Jensen ("Jensen") and Thomas C. Tekulve, Jr.  
31 ("Tekulve") (collectively "Defendants"). The Court held a nine-day trial starting on October 15,  
32 2013.

33 Having considered the arguments of the parties and the testimony and exhibits presented at  
34 trial, the Court makes the following findings of fact and conclusions of law.

35 **I. Findings of Fact**

36 **A. Stipulated Facts**

37 The following facts were agreed to be true by the parties in the Final Pre-Trial Conference  
38 Order. Doc. no. 193.

39 Jensen is the founder of Basin Water, Inc. ("Basin"). He was chief executive officer and

1 chairman of the Board of Directors of Basin from December 1999 until February 19, 2008, when  
2 he resigned as CEO. Jensen continued to be a member of the Board of Directors, however, until  
3 March 11, 2008. Jensen received a master's degree in Chemical Engineering from the  
4 Massachusetts Institute of Technology in 1974.

5 Tekulve was the chief financial officer of Basin from September 2004 to May 2008 and  
6 Vice President of Business Development from June 2008 until he resigned effective October 8,  
7 2008. As CFO, Tekulve had responsibility for, among other things, Basin's financial structure and  
8 organization. Prior to his tenure at Basin, Tekulve was an officer of two other public companies:  
9 from 1999 to 2004 he was the VP of Finance of Southwest Water, Inc., and from 1994 to 1998 he  
10 was the CFO of Safeguard Health Enterprises. Tekulve was licensed by the State of Oregon as a  
11 certified public accountant in 1978. During the relevant period, Tekulve's CPA license was on  
12 inactive status. Tekulve earned an MBA degree in 1987. Basin was a Delaware corporation  
13 headquartered in Rancho Cucamonga, California. During the relevant period, Basin was engaged  
14 in the business of designing, manufacturing and servicing groundwater treatment systems. It was  
15 founded by Jensen on or about December 1999. Basin became a public company on May 11,  
16 2006, when its stock was initially registered with the Commission pursuant to Section 12(g) of the  
17 Exchange Act, Title 15 U.S.C. § 78l(g). Basin's stock traded on the Nasdaq National Market until  
18 July 31, 2006, when its common stock became registered pursuant to Section 12(b) of the  
19 Exchange Act, Title 15 U.S.C. § 78l(b), and began trading on the Nasdaq Global Market. On  
20 August 5, 2009, the Nasdaq delisted Basin's stock effective August 17, 2009.

21 Singer Lewak Greenbaum & Goldstein, LLP ("SingerLewak" or "Singer") was Basin's  
22 outside auditor throughout the time period relevant to this case.

23 Jensen and Tekulve signed various management representation letters that were sent to  
24 SingerLewak, as well as quarterly and annual reports (on Forms 10-Q and 10-K) which were filed  
25 with the SEC on behalf of Basin. Tekulve also reviewed and caused to be filed with the SEC  
26 several earnings releases.

27 From December 12, 2006 through August 2008 Jensen sold shares of Basin stock that he  
28 owned. During that time period, he also donated shares of Basin stock to MIT.

On February 10, 2009, Basin filed a restatement on Form 10-K/A (“Restatement”) with the Commission. The Restatement amended the annual report on Form 10-K for the year ended December 31, 2007, filed with the Commission on March 17, 2008. The Restatement also included amended and restated consolidated financial statements and related financial information for the years ended December 31, 2006 and 2007, including the financial results in each of the quarterly periods in 2006 and 2007.

***B. Witnesses Called by the Parties***

The SEC called the following witnesses: Defendant Thomas Tekulve; Martin Benowitz, with whom Basin negotiated the Opus Trust transaction; James Sabzali, with whom Basin negotiated the Thermax transaction; Lloyd Ward, the managing member of VLC and WSS; Michael Stark, Basin’s former CEO; Defendant Peter Jensen; Marc Florin, a stockbroker for Jensen; and Professor Carla Hayn, the SEC’s expert on accounting and financial reporting.

In their case in chief, Defendants called the following witnesses: Keith Solar, former Chairman of Basin’s Board of Directors; Pat Kelly, Basin’s former General Manager; Defendant Thomas Tekulve; Victor Fryling, former Chairman of Basin’s Audit Committee; Divakar Gupta of Latham & Watkins, Basin’s former outside securities counsel; Leslie Ward-Cline, Basin’s former Controller; and Professor William Holder, Defendants’ expert on accounting and financial reporting.

The Court makes the following findings regarding the credibility of the witnesses:

Sabzali’s testimony suffered from a lack of credibility in general. He admitted at trial that he had pled guilty to a felony and that he had committed the act to which he had pled guilty (Sabzali, Trial Tr. at 482:17-483:5.) He was impeached with testimony from his deposition where he denied that he had engaged in the conduct to which he pled guilty. (*Id.* at 482:17-484:6.) Assessing these facts, along with Sabzali’s demeanor and attitude during his testimony, the Court places little weight on the substance of his testimony.

Lloyd Ward testified on direct examination that he is a lawyer in private practice in Dallas, Texas (Ward, Trial Tr. at 489:21-490:7.) On cross-examination, however, he admitted that in [July] 2013, his license to practice law was suspended for eleven months. Ward was placed on two

1 months of active suspension and nine months of probation. The basis of his suspension was an  
2 ethical violation as a member of the Texas bar. (*Id.* at 533:9-534:5.) Ward also admitted that he is  
3 subject to a 2011 Cease and Desist Order by the Connecticut [Banking Commission] for providing  
4 illegal debt relief services to over 50 Connecticut residents. The Connecticut [Banking  
5 Commission] enjoined Ward from further violations of law and ordered him to pay a \$500,000  
6 fine (*Id.* at 534:9-536:6.) Ward further admitted that he is subject to a final judgment in Kansas for  
7 providing illegal debt relief services in that state. The Kansas court enjoined Ward and ordered  
8 him to pay a \$100,000 fine (*Id.* at 539:12-540:5.) Considering these facts, as well as Ward's  
9 demeanor and attitude during his testimony, the Court places little weight on the substance of his  
10 testimony.

11 Michael Stark testified that he did not have a close personal relationship with Charles Litt,  
12 and that he had never done a deal with Litt before VLC (Stark, Trial Tr. at 603:19-604:19.) He  
13 testified that he played a marginal role in the VLC transaction, merely introducing Litt to Tekulve  
14 and, in substance, leaving the two of them to determine whether and how to pursue a third-party  
15 financed sale (*Id.* at 605:23-606:6, 634:5-636:6). The Court finds Stark to have been impeached on  
16 each of these points.

17 At the time he began work at Basin, Stark had just returned from a three-week vacation in  
18 Italy with Litt and his wife, who was Stark's wife's cousin (*Id.* at 638:4-7.) Email correspondence  
19 between Litt and Stark included exchanges of holiday greetings and terms of endearment such as  
20 "We love you and miss you all." (*Id.* at 635:10-21.) Stark testified in his deposition that he  
21 considered Litt a member of the family and that they, in fact, had a close personal relationship (*Id.*  
22 at 639:12-21.)

23 Stark testified at trial that he had never done a deal with Litt before VLC (*Id.* at 604:2-9.)  
24 He was confronted on cross-examination with a May 12, 2007 email to a business colleague in  
25 which he stated, "I have a financial guy who does all my deals. . . . His name is Charlie Litt." (*Id.*  
26 at 644:9-18.) Stark testified that the email, rather than his trial testimony, was false (*Id.* at 645:1-  
27 6.) At trial, Stark had a motive to disassociate himself from prior dealings with Litt; therefore the  
28 Court believes that the email likely more closely portrays the truth of Stark's prior business

1 relationship with Litt. Either way, the Court finds Stark's credibility to have been impeached.

2 Stark's characterization of his role in the VLC transaction was contradicted by a series of  
3 email exchanges and transcripts of analyst calls from 2007 (Exs. 812, 813, 815, and 816 emails  
4 with Litt.) Based on those documents, it was clear to the Court that Stark not only knew the terms  
5 of the VLC transaction but was the principal driving force behind it.

6 Considering these facts, as well as Stark's demeanor and attitude while testifying, the  
7 Court finds that Stark was lacking in credibility and assigns little weight to the substance of his  
8 testimony.

9 Professor Hayn and Professor Holder testified, respectively, as the SEC's and Defendants'  
10 expert accountant. While both are highly qualified academics who are extremely knowledgeable in  
11 their field, the Court found Professor Holder's testimony more persuasive.

12 The Court finds that the methodology used by Professor Hayn to arrive at her opinions was  
13 unreliable. In the Court's view, Professor Hayn's opinion did not sufficiently take into  
14 consideration the role of professional judgment in accounting for transactions and relied  
15 excessively on hindsight in evaluating the accounting issues in this case, rather than viewing the  
16 facts as they existed at the time. The Court considers Professor Holder's opinion to reflect a more  
17 real world view of the events and accounting issues in this case.

18 The Court finds all of the other witnesses who testified in this case to be credible.

19 ***C. Facts Established at the Trial***

20 **1. General Characteristics of the Company, Including its Products, Practices and**  
21 **Personnel**

22 Jensen is a chemical engineer who developed a technology to provide municipalities with  
23 drinking water by using an ion-exchange method to remove contaminants such as nitrate and  
24 perchlorate. (Solar, Trial Transcript ("Trial Tr.") at 1143:4-22.) In 1999, Jensen started Basin with  
25 the help of his wife Lorna Jensen. (*Id.* at 1146:10-17, 1145:4-7; Exhibit 1645 (First Actions of  
26 Basin Board of Directors) at 1645-1.)

27 Jensen's application of ion-exchange technology differed from existing methods of treating  
28 water. (Solar, Trial Tr. at 1143:4-22.) Before Basin, water treatment facilities were large and

1 capital-intensive. (*Id.* at 1143:4-22.) Conventional facilities used miles of pipe to carry  
 2 contaminated water from wellheads to a central facility to clean the water and then transport the  
 3 cleaned water to consumers. (*Id.*) Basin changed this model. It constructed relatively small  
 4 ionexchange units and installed these units directly atop well-heads, obviating the need for a  
 5 central treatment facility and the attendant infrastructure. (*Id.*)

6 In Basin's early years, Jensen was responsible for operations of the company, customer  
 7 service, attracting investors, and development of Basin's business strategy. (Fryling, Trial Tr. At  
 8 1385:16-25; Solar, Trial Tr. at 1147:19-23.)

9 Just a few years after its founding, Basin had contracts with several large municipalities in  
 10 California and was purifying millions of gallons of drinking water each day. (See Solar, Trial Tr.  
 11 at 1150:23-1151:7 (Basin demonstrated that its technology worked by getting units out in the  
 12 field); Tekulve, Trial Tr. at 1284:18-20 (Basin's customers were principally municipalities).)

13 Jensen was neither an accountant nor known for his accounting acumen. (Fryling, Trial Tr.  
 14 at 1386:8-16; Solar, Trial Tr. at 1156:24-1157:10 (Board "didn't expect Peter [Jensen] to review  
 15 financial statements").) For the first few years of its existence, Basin relied on a single part-time  
 16 accountant to manage its books. (Tekulve, Trial Tr. at 109:11-18; Jensen, Trial Tr. at 989:20-24;  
 17 Solar, Trial Tr. at 1149:17-1150:1.) As Basin grew, Jensen saw the need for a larger and more  
 18 sophisticated accounting department. (Jensen, Trial Tr. at 988:13-18; Tekulve, Trial Tr. at 109:3  
 19 18 (responsibility for Basin's financial structure and organization); Solar, Trial Tr. at 1157:3-13  
 20 (Jensen's responsibility was "to hire and staff an accounting group."))

22 After conducting a national search, Jensen hired Thomas Tekulve in 2004 as Chief  
 23 Financial Officer to establish financial controls to support Basin. (Jensen, Trial Tr. at 988:19-23.).  
 24 Prior to Basin, Tekulve had been Vice President of Finance and Treasurer of Southwest Water, a  
 25 large water utility that operated in the same market as Basin. (Tekulve, Trial Tr. at 108:7-15;  
 26 Jensen, Trial Tr. at 988:24-989:7; Final Pretrial Conf. Order (Doc. No. 193), ¶5(b) at 4.)

27 Tekulve's first order of business was to create a finance and accounting department by  
 28 hiring the necessary personnel and developing the necessary systems and processes. (Jensen, Trial

1 Tr. at 989:25-990:12; Tekulve, Trial Tr. at 109:11-18; Ward-Cline, Trial Tr. at 1257:16-1258:11.)  
2 For personnel, Tekulve drew heavily on his colleagues from Southwest Water, hiring Doug  
3 Hansen as his Director of Finance and Leslie Ward-Cline as his Controller. (Tekulve, Trial Tr. at  
4 109:11-20, 1286:4-9.)

5 Tekulve and his colleagues in the finance department put in place accounting processes  
6 and procedures that would allow Basin to issue a public offering. (Tekulve, Trial Tr. at 1285:25  
7 1286:20; Ward-Cline, Trial Tr. at 1258:12- 1259:20.) This work included creating policies and  
8 procedures to ensure accountability within the accounting department, to ensure that Basin's  
9 financial statements would comply with Generally Accepted Accounting Principles ("GAAP"),  
10 and to enable the company to satisfy Sarbanes-Oxley reporting requirements. (Tekulve, Trial Tr. at  
11 1285:25-1287:6; Ward-Cline, Trial Tr. at 1258:12-1259:20.) Tekulve and Leslie Ward-Cline both  
12 stated that the policies and procedures put in place were effective in ensuring compliance with  
13 GAAP and Sarbanes-Oxley. (Tekulve, Trial Tr. at 1286:21-22; Ward-Cline, Trial Tr. at 1261:7-  
14 20.)

15 In 2005, Tekulve began searching for an outside auditor with public company experience  
16 to support Basin's goal of going public. (Tekulve, Trial Tr. at 1288:15-24.) After interviewing  
17 several audit firms, Tekulve recommended that Basin's Audit Committee hire Singer. (Tekulve,  
18 Trial Tr. at 1288:22-1289:6, 1290:8-13.)

19 Tekulve recommended Singer because he was impressed with the engagement partner Gale  
20 Moore's background with two Big Four accounting firms and years of audit experience. Also  
21 important to Tekulve's choice was Moore's willingness to consult with Basin on an ongoing basis,  
22 which Tekulve considered to be critical given Basin's small size and relative inexperience.  
23 (Tekulve, Trial Tr. at 1289:20-1290:1, 1290:14-22.)

24 After Basin went public in May 2006, Singer began performing quarterly reviews and  
25 annual audits at Basin's headquarters. (Tekulve, Trial Tr. at 1304:2-10, 1304:23-1305:1; Ward  
26 Cline, Trial Tr. at 1267:1-7, 1270:16-24; Ex. 630 at SEC-LA3478-01646017 (Singer Audit Report  
27 for 2006); Ex. 236 at SECLA3478- 00003247 (Singer Audit Report for 2007).) Because Basin  
28 typically conducted only a few transactions each quarter, Singer's quarterly reviews generally



1 included 100% of the significant transactions for the quarter. (Tekulve, Trial Tr. at 1304:12-22;  
 2 Ward-Cline, Trial Tr. at 1270:25-1271:5.) Singer had complete, open, and unfettered access to all  
 3 of Basin's financial records. (Tekulve, Trial Tr. at 1305:2-8; Ward-Cline, Trial Tr. at 1273:10-20.)  
 4 Singer was also provided with all of the information it requested from Basin's finance department.  
 5 (Tekulve Trial Tr. at 387:2-6, 1304:23-1305:8; Ward-Cline, Trial Tr. at 1271:6-10; Fryling, Trial  
 6 Tr. at 1374:3-1375:5; Gupta, Trial Tr. at 1405:11-15.) Even apart from the quarterly reviews and  
 7 annual audits, Tekulve and his finance team often consulted with Moore and her team at Singer  
 8 regarding the proper accounting for specific transactions. (Ex. 913 (2/23/2006 e-mail string  
 9 between Gale Moore and Doug Hansen regarding review of Benowitz transaction); Tekulve, Trial  
 10 Tr. at 1302:2-1303:2; Ward-Cline, Trial Tr. at 1264:8-1265:17.)

11 As part of its engagement, Singer met with Basin's Audit Committee prior to the release of  
 12 Basin's Form 10-Q. (Tekulve, Trial Tr. at 1299:9-24; Fryling, Trial Tr. at 1373:17-1375:14;  
 13 Gupta, Trial Tr. at 1405:7-10.) The Basin Audit Committee was comprised of members who, in  
 14 the words of one Basin Director, had the expertise to serve as Basin's CFO. (Solar, Trial Tr. at  
 15 1152:22- 1153:3.) The Audit Committee met at least quarterly and reviewed material  
 16 transactions. (Fryling, Trial Tr. at 1371:4-13, 1397:25-1398:2.) As Singer concluded in a 2007  
 17 audit work paper, "the potential risk of material misstatement due to fraud . . . is low because the  
 18 audit committee pays close and detail[ed] attention to operations and transactions." (Ex. 887  
 19 (3/15/08 Singer Discussion).)

20 Basin's Audit Committee was chaired by Victor Fryling, who had previously served as the  
 21 CFO of Fortune 500 company. (Fryling, Trial Tr. at 1365:11-20.) Usually, Fryling held a "pre  
 22 meeting" with Tekulve to discuss the quarterly results and the Audit Committee presentation.  
 23 (Fryling, Trial Tr. at 1370:18-1371:13; Tekulve, Trial Tr. at 1295:12-1296:15, 1297:2-23.)  
 24 Tekulve circulated a draft 10-Q to members of the Audit Committee before the meetings. (Ex. 679  
 25 (8/7/2007 e-mail from Tekulve to Audit Committee with draft 10-Q for Second Quarter 2007);  
 26 Tekulve, Trial Tr. at 1298:22-1299:8.) Fryling and the other members of Basin's Audit Committee  
 27 provided a "robust" examination of the proposed financial statements submitted by Tekulve.  
 28 (Fryling Trial Tr. at 1366:8-1370:2, 1371:14-20.)



1 At every Audit Committee meeting, the Committee would have discussions with Singer,  
 2 usually without management present. (Fryling, Trial Tr. at 1373:17-1375:15; Tekulve, Trial Tr. at  
 3 1299:25-1300:18.) During each of these discussions, the Audit Committee members asked Singer  
 4 if it had any disputes with management and if management had cooperated fully with Singer's  
 5 review. (Fryling, Trial Tr. at 1374:3-1375:15; Gupta, Trial Tr. at 1405:11-15.) Singer never  
 6 reported any disputes with management or impediments in auditing Basin's financial statements.  
 7 (Fryling, Trial Tr. at 1374:3-1375:3; Gupta, Trial Tr. at 1405:11-15.) The Audit Committee also  
 8 asked if there were any issues related to Basin's accounting that they should know about; Singer  
 9 reported none. (Fryling, Trial Tr. at 1374:3-1375:3; Gupta, Trial Tr. at 1405:11-15.)

10 Following each quarter Singer issued clean reviews and at each year end, Singer issued  
 11 clean audit opinions. (Fryling, Trial Tr. at 1373:17-1375:3; Holder, Trial Tr. at 1459:9-14; Ex. 630  
 12 at SEC-LA3478-01646017 (Singer Audit Report for 2006); Ex. 236 at SEC-LA3478-00003247  
 13 (Singer Audit Report for 2007).)

14 There were other levels of review for transactions at Basin in addition to Singer. The terms  
 15 of material transactions were also reviewed by the Board of Directors. (*See, e.g.*, Tekulve, Trial  
 16 Tr. at 363:1-7 (reviewing basic structure and economics of transaction for VLC at Board meeting);  
 17 Solar, Trial Tr. at 1159:1-1160:10 (reviewing Opus transaction).) Given Basin's relatively small  
 18 size, nearly all transactions in each quarter were material. (Solar, Trial Tr. at 1179:5-16 (General  
 19 Counsel Scott Hamilton determined that all transactions were material).)

20 Significant transactions – including the SPE transactions at issue in this litigation – were  
 21 reviewed by Basin's legal counsel as well. Before the IPO, Solar, one of the original directors and  
 22 a lawyer with expertise in the water industry, reviewed agreements and provided draft templates to  
 23 Tekulve. (Solar, Trial Tr. at 1135:3-21, 1136:22-1137:6, 1138:7-16, 1138:24-1139:8.) In  
 24 connection with its IPO, Basin retained Latham & Watkins ("Latham") as outside counsel. Going  
 25 forward, Latham served as Basin's securities counsel, drafting and reviewing its filings with the  
 26 SEC and drafting the documentation for several significant transactions. (Gupta, Trial Tr. at  
 27 1400:12-1401:24, 1402:7-24; Solar, Trial Tr. at 1139:13-21.) Both Jensen and Tekulve sought and  
 28 received counsel from Latham on securities law issues. (Gupta, Trial Tr. at 1410:14-24, 1412:23-

1 1414:11.)

2 Scott Hamilton, Basin's General Counsel hired in June 2007, served as an additional level  
 3 of review. (Jensen, Trial Tr. at 905:7-21; Solar, Trial Tr. at 1169:13-22; Ex. 211 (Form 10Q for  
 4 Q2 2007) at SEC-LA3478-00002975.) Hamilton, a former attorney in the Division of  
 5 Enforcement of the SEC, had worked with Stark at Veolia and was hired at his recommendation.  
 6 (Stark, Trial Tr. at 678:10-23; Solar, Trial Tr. at 1169:2-9.) The Basin Board hired Hamilton in  
 7 part because of his experience as an attorney in the Division of Enforcement at the SEC. (Solar,  
 8 Trial Tr. at 1169:13-22 (The Board viewed the hiring of a former enforcement attorney as "a good  
 9 thing" because "[i]t would help to have someone who worked at the SEC so that the Company was  
 10 doing everything it should in accordance with SEC rules and regulations").) Hamilton was  
 11 involved in reviewing and documenting the SPE transactions, and Tekulve interacted with him in  
 12 this review process. (Stark, Trial Tr. at 615:15-25 (Stark, Basin's COO and President, received  
 13 information "in terms of the contractual agreements" from Scott Hamilton), 679:2-4 (appears that  
 14 "three attorneys working on reviewing the – this [VLC] transaction"), 685:9-12 ("reassured by this  
 15 process that the VLC transaction had been appropriately reviewed and approved"); Tekulve, Trial  
 16 Tr. at 213:1-12 ("we had multiple discussions with Scott Hamilton, our general counsel..."); Ex.  
 17 1020 (Tekulve Diary) at TCT 248 ("Calls, e-mails, et cetera with Charlie Litt, Scott Hamilton  
 18 ..."); Ex. 619 (8/9/07 Audit Committee Minutes).)

19 Jensen himself never participated in decisions on how or when to recognize revenue from  
 20 transactions. (Jensen, Trial Tr. at 852:19-854:6, 905:7-906:8; Kelly, Trial Tr. at 1240:10-13;  
 21 Ward-Cline, Trial Tr. at 1275:5-1277:10; Fryling, Trial Tr. at 1387:2-5.)

22 Neither Jensen or Tekulve ever instructed any Basin employee to withhold information  
 23 from Singer, or to provide less than full cooperation with the auditors. (Ward-Cline, Trial Tr. at  
 24 1272:1-12, 1277:11-20; Jensen, Trial Tr. at 993:25-996:5; Tekulve, Trial Tr. at 1344:6-12, 1349:5-  
 25 25; Fryling, Trial Tr. at 1373:21-1374:9; Kelly, Trial Tr. at 1240:14-25.) No witness testified that  
 26 Tekulve or Jensen ever instructed any Basin employee to do an improper act. All witnesses who  
 27 were asked testified to the absolute integrity, prudence, and honesty of both men. (Kelly, Trial Tr.  
 28 at 1241:8-19 (did not have any reason to doubt Jensen's integrity or honesty), 1248:2-9; Ward

1 Cline, Trial Tr. at 1278:5-8 (did not have “any occasion to doubt his [Jensen’s] integrity or his  
 2 honesty”), 1274:1-19 (Tekulve “wanted thing[s] to be right and that was the message that he  
 3 conveyed to his staff”), 1262:12-16 (Tekulve “wanted them [Basin’s financial statements] to be  
 4 right”); Solar, Trial Tr. at 1190:3-1191:4 (“Because I have known Peter [Jensen] more than 20  
 5 years, and I know he is not like that. And I was there when the alleged events happened, and they  
 6 weren’t true.”), 1210:14-22 (“Tom [Tekulve] is impeccably honest.”); Gupta, Trial Tr. at 1405:16-  
 7 21 (Singer did not question Tekulve’s honesty or ethics), 1410:25-1411:1 (“As far as I saw, he  
 8 was very honest. I always trusted him in the transactions – in the interactions I had with him  
 9 [Tekulve].”).)

## 10 **2. Transactions at Issue in this Case**

11 With the exception of certain circumstances regarding the insider trading allegations  
 12 against Jensen, the alleged misconduct in this case centers around six transactions. The SEC  
 13 alleges that Defendants improperly recognized revenue on these transactions—or otherwise  
 14 misrepresented the character of those transactions—and in doing so misled the investing public,  
 15 Singer, and the SEC.

### 16 **a. Opus Trust Transaction**

17 In 2005, Jensen approached potential investors about acquiring water treatment systems  
 18 from Basin to use in possible conjunction with BION, a new, proprietary technology Jensen  
 19 helped to develop along with internationally-known experts in the field of water treatment.  
 20 (Jensen, Trial Tr. at 815:17-816:10.)

21 In the Fall of 2005, Jensen spoke with attorney Martin Benowitz about Opus acquiring two  
 22 water treatment systems and an interest in the BION technology from Basin. (Jensen, Trial Tr. at  
 23 817:9-818:22; Benowitz, Trial Tr. at 405:1-20.) Benowitz was a shareholder of Basin. Further,  
 24 Jensen had a long business relationship with Benowitz and understood him to represent foreign  
 25 investors. (Jensen, Trial Tr. at 815:14-16, 958:6-959:17; Benowitz, Trial Tr. at 442:2-7; Solar,  
 26 Trial Tr. at 1159:1-1160:2.) Benowitz also represented a group of foreign investors who did  
 27 business through an entity known as Opus Trust (“Opus”). Benowitz was enthusiastic about the  
 28 BION technology. (Benowitz, Trial Tr. at 407:22-408:2 (“[T]he motivation for us to get an interest

1 here was that the thought was that this was something that could not only be used by Basin, but  
2 would be a product that could be used by any other water company that needed to dispose of that  
3 which would make it a much substantial market.”), 434:21-435:4 (“It was all about the stock... it  
4 was all about the five percent stock ownership.”); Jensen, Trial Tr. At 959:1-10 (“[H]e [Benowitz]  
5 was very excited about the technology”). Benowitz agreed that Opus would buy two Basin  
6 systems if the deal included BION shares. (Benowitz, Trial Tr. at 408:11-14 (“We were getting  
7 two units and five percent of the stock of BION”), 434:21-435:4; Ex. 12 (3/30/06 Formal  
8 Agreement); Ex. 514 (Letter Agreement).) Once Jensen and Benowitz reached a basic agreement  
9 in December 2005, the Basin Board of Directors reviewed the deal terms and approved it on  
10 December 20, 2005. (Solar, Trial Tr. at 1159:4-1160:4.)

11 On December 29, 2005, Benowitz, on behalf of Opus, executed an “Agreement for  
12 purchase of two Basin ion exchange units” (“Letter Agreement”). (Benowitz, Trial Tr. at 409:25-  
13 410:12; Ex. 514 (Letter Agreement). The Letter Agreement stated a purchase price of \$1.5  
14 million, with 10% (or \$150,000) to be paid upon execution, and the remainder to be paid over two  
15 years. (Ex. 514 (Letter Agreement), ¶ 1a. at SEC-LA3478-00842086.) In exchange, Opus would  
16 receive 5% of the shares of the subsidiary that would own the BION technology. Opus  
17 immediately paid Basin \$150,000. (Ex. 4 (12/29/05 Checks).) Benowitz testified that the Letter  
18 Agreement was binding. (Benowitz, Trial Tr. at 435:24-436:20 (“it was your full intention that it  
19 [Ex. 514] be binding on the Opus Trust, correct? A: Correct”).) The Letter Agreement also  
20 explicitly states that it is “binding” on both parties. (Ex. 514 (Letter Agreement), ¶ 5 at SEC-  
21 LA3478-00842088.)

22 The Letter Agreement contained the key economic terms of the sale, and committed the  
23 parties to enter into a more detailed contract containing customary terms and conditions at a later  
24 date. (Ex. 514 (Letter Agreement), ¶ 1 at SEC-LA3478-00542087.) Basin had a practice of  
25 establishing the key terms of a transaction in a letter agreement, followed by a more detailed  
26 contract that would include more customary terms and conditions. (Tekulve, Trial Tr. at 1295:25-  
27 1296:10.)

28 In March 2006, Benowitz obtained a home equity loan of \$250,000 to pay for an option to

1 extend the Letter Agreement. (Benowitz, Trial Tr. at 429:13-18, 439:21-23; Ex. 529 (3/20/06 E-  
 2 mail).) During this time, however, Jensen and Tekulve were preparing for Basin's IPO, which  
 3 occurred in May 2006. (Jensen, Trial Tr. at 829:17-25; Final Pretrial Conf. Order (Doc. No. 193),  
 4 ¶5(c) at 4.) Hence, Tekulve and Benowitz did not exchange drafts of more formal documentation  
 5 of the agreement ("Unit Purchase Agreement" or "UPA") until June 2006. The Unit Purchase  
 6 Agreement ("UPA") was executed by Benowitz sometime after March 30, 2006, (Benowitz, Trial  
 7 Tr. at 437:8-20; Ex. 12 (UPA)), and by Jensen some time before September 2006, (Jensen, Trial  
 8 Tr. at 844:15-845:9).

9 The UPA stated that it was "effective as of" March 30, 2006. (Ex. 12 (UPA) at SEC-  
 10 LA3478-1919.) Benowitz testified that, in his experience as a transactional attorney, parties use  
 11 the phrase "effective as of" to indicate they entered the agreement prior to executing it. Used this  
 12 way, "effective as of" does constitute "backdating." The UPA, on its face, clearly indicates that it  
 13 is effective "as of" March 30, 2006; it does not purport to have been signed on March 30, 2006.  
 14 (Benowitz, Trial Tr. at 437:21-438:14.) Contrary to the SEC's allegations, it is thus not a back-  
 15 dated document. (*Id.*) Benowitz testified that on April 1, 2006, he began receiving lease payments  
 16 due under both the Letter Agreement and the Unit Purchase Agreement. Benowitz's receipt of  
 17 these payments as owner of the water treatment units supports that the sale was "effective as of"  
 18 March 30, 2006. (Ex. 5 (Payments to Western Water); Benowitz, Trial Tr. at 432:12-19.)

19 The UPA modified certain terms of the Letter Agreement. The Letter Agreement did not  
 20 specifically identify the two units being sold to Opus, whereas the UPA identified them by unit  
 21 numbers. The parties to the Letter Agreement were Basin and Opus, whereas the parties to the  
 22 UPA were BionBasin, Inc., a wholly-owned subsidiary of Basin, and Opus. (Ex. 514 (Letter  
 23 Agreement); Ex. 12 (UPA); Tekulve, Trial Tr. at 346:19-347:5.) The term of the UPA was three  
 24 years, whereas the term of the Letter Agreement was two years. (Ex. 12 (UPA), ¶2.1 at SEC-  
 25 LA3478-1920; Ex. 514 (Letter Agreement), ¶2(b)(ii) at SEC-LA3478-09530986.)

26 The UPA also included a liquidated damages clause. (Hayn, Trial Tr. at 1009:17-1010:7.)  
 27 Under the liquidated damages clause, if Opus breached the agreement, Basin's damages were  
 28 limited to retaining any sums Opus had paid prior to breach, and the return of the two units. (Ex.

12 (UPA), ¶18 at SECLA3478-1927.) Benowitz testified that he did not request the liquidated damages clause. (Benowitz, Trial Tr. at 438:19-439:1.) Tekulve testified that he believed the clause may have been a vestige of a contractual template he relied on in preparing a draft of the UPA. (Tekulve, Trial Tr. at 1310:11-21, 1311:2-5; *see also* Solar, Trial Tr. at 1160:17-1161:12.)

Regardless of the liquidated damages clause, Benowitz testified that Opus had a significant economic incentive to perform its obligations. “The whole purpose” of the agreement with Basin, as far as Benowitz was concerned, was to obtain the 5% share of BionBasin, Inc. (Benowitz, Trial Tr. at 425:17-23 (“really, our big concern was about the five percent interest in the stock”), 434:21-435:4 (“It was all about the stock ... It was all about that five percent stock ownership”), and 439:2-12 (“This was all about getting that five percent stock”).) If Opus did not pay for the two units in full, it would not receive the shares in BionBasin, Inc. (Benowitz, Trial Tr. at 439:13-17.) Thus Opus fully intended to perform, had in fact obtained funding (through the Benowitz home equity line) to perform, and understood that one way or the other Basin would have “to be paid” and that Opus “would have to do that.” (Benowitz, Trial Tr. at 418:21-419:17.)

The terms and conditions added in the UPA were not intended to modify the material economic terms of the Letter Agreement but were added to protect Basin’s intellectual property rights in connection with its water processing units and to provide standard “boilerplate” contractual terms. (Tekulve, Trial Tr. at 120:25-121:16.) Singer was familiar with Basin’s practice of documenting a transaction through a letter agreement that set forth the key economic terms, followed by a more formal contract. (Tekulve, Trial Tr. at 345:24-13.)

Basin provided the Letter Agreement to Singer in the first quarter of 2006. (Ex. 913 (2/23/2006 email string between Doug Hansen and Gale Moore re Benowitz transaction); Tekulve, Trial Tr. at 1307:9-22.) In February 2006, Singer advised Basin that it could not record revenue from the sale to Opus in the fourth quarter of 2005 because the Letter Agreement did not identify the specific units sold. (Tekulve, Trial Tr. at 1307:9-22.) Basin followed Singer’s advice. In March 2006, Basin identified the specific units sold to Opus and recognized revenue in the first quarter of 2006. (Tekulve, Trial Tr. at 1307:9-1308:1.) On June 26, 2006, Basin filed its 10-Q for the first quarter of 2006, including \$1.5 million in revenue from the Opus sale. (Ex. 628 (6/26/2006 Basin

1 10-Q for the Q1 2006.)

2 In determining whether to recognize revenue for public companies, accountants evaluate a  
3 series of factors outlined by the SEC in Staff Accounting Bulletin 104 (“SAB 104”). (Hayn, Trial  
4 Tr. at 1007:13-24; Holder, Trial Tr. at 1446:18-1447:2.) These criteria include: (1) whether there  
5 is persuasive evidence of an arrangement; (2) whether delivery has occurred or services have been  
6 rendered; (3) whether the price is fixed or determinable; and (4) whether collectability is  
7 reasonably assured. (Hayn, Trial Tr. at 1007:18-1008:4; Holder, Trial Tr. at 1447:13-1448:6.) The  
8 SAB 104 criteria apply to all six transactions at issue in this case.

9 The revenue Basin recognized on Opus Trust in the first quarter of 2006 was based on the  
10 Letter Agreement, which constituted “persuasive evidence of an arrangement,” under SAB 104.  
11 (Tekulve, Trial Tr. at 346:14-15; Holder, Trial Tr. at 1459:16-1460:4.) Ownership of the units was  
12 transferred to Opus Trust as of March 30, 2006, and the \$1.5 million price for the sale was fixed  
13 by the terms of the Letter Agreement. (Tekulve, Trial Tr. at 131:24-132:9, 343:10-344:7, 1309:15-  
14 25; Holder, Trial Tr. at 1460:8-19, 1461:17-21.) Sufficient evidence enabled Tekulve and Basin to  
15 conclude that collectability from Opus Trust was reasonably assured. That evidence included the  
16 \$150,000 cash down payment, the Basin Board of Director’s approval of the transaction, and  
17 Benowitz’s long- standing business relationship with both Basin and Jensen. (Tekulve, Trial Tr. at  
18 113:19-114:3, 129:17-25, 343:24-344:4; Holder, Trial Tr. at 1461:24-1462:12.) Under these  
19 circumstances, Tekulve’s decision to recognize revenue from the Opus Trust transaction was  
20 reasonable under GAAP. (Holder, Trial Tr. at 1459:16-1462:12; Ex. 1762 (SAB 104 factors  
21 applied to Opus transaction).)

22 Tekulve reasonably relied on the professional advice of Basin’s auditors in deciding to  
23 recognize revenue from the Opus Trust transaction in the first quarter of 2006. (Tekulve, Trial Tr.  
24 at 1311:20-1312:5; Holder, Trial Tr. at 1462:14-1463:8.) Basin provided Singer with the Letter  
25 Agreement and disclosed all material information related to the Opus Trust transaction. (Tekulve,  
26 Trial Tr. at 1311:5-9, 1311:16-19; Ward-Cline Trial Tr. at 1270:25-1271:10; (Ex. 913 (2/23/2006  
27 e-mail string between Doug Hansen and Gale Moore re Opus transaction.)) Singer provided  
28 specific guidance regarding revenue recognition for the transaction, and Tekulve followed that



1 advice. (Tekulve, Trial Tr. at 1308:2-9, 1307:13-22.)

2 Singer received the UPA in August 2006. (Ex. 866 (8/1/2006 e-mail from Tekulve to  
3 Helen Wu at Singer, attaching UPA); Tekulve Trial Tr. at 147:9-15.) Singer possessed the UPA,  
4 which included the liquidated damages clause, at the time Singer performed its audit of Basin's  
5 year-end 2006 financial statements. As part of the 2006 year-end audit, Singer obtained third-party  
6 confirmation of the Opus Trust transaction. (Ex. 528 (2/9/2007 Letter from M. Benowitz to Singer  
7 and attaching Basin Water Audit Letter Acknowledgment Regarding Ion Exchange Units);  
8 Benowitz, Trial Tr. at 441:8-442:1.) No one at Basin made misleading statements to Singer about  
9 the transaction or withheld requested information or documents. (Tekulve, Trial Tr. at 348:15-17;  
10 Ward-Cline, Trial Tr. at 1272:1-12.) Singer approved Basin's decision to record revenue on the  
11 Opus Trust transaction in its 2006 year-end financial statements.

12 Only in hindsight has the Opus Trust transaction come under attack. (Holder, Trial Tr. at  
13 1445:16-23.) In 2008, one of the units was damaged in an automobile accident before Opus Trust  
14 had made its final scheduled payment. (Tekulve, Trial Tr. at 344:8-21, 345:12-20.) The accident  
15 resulted in threatened litigation between Opus Trust and Basin over responsibility for insuring the  
16 units and the interpretation of the liquidated damages clause in the UPA. (Tekulve, Trial Tr. at  
17 344:8-345:11.) A car running off the road and crashing into a unit is not something that Tekulve  
18 could have foreseen when he decided to recognize revenue on this transaction in 2006. The mere  
19 existence of the liquidated-damages clause at that time does not make the decision to recognize  
20 revenue unreasonable. (Holder, Trial Tr. at 1464:23-1465:23.) Professor Hayn's focus on the  
21 liquidated damages clause is an example of her flawed methodology of relying excessively on  
22 hindsight to analyze a transaction, as the liquidated damages clause only became an issue after the  
23 occurrence of the unforeseeable automobile accident.

#### 24 **b. Thermax Transaction**

25 In late 2005, Jensen was contacted by James Sabzali, a salesman for Thermax, a large  
26 international company that sells resins and water treatment systems in Asia and world-wide.  
27 Sabzali and Jensen discussed the possibility of entering into a broad-based strategic relationship  
28 between Thermax and Basin. Sabzali also told Jensen that Thermax wanted to sell Basin systems

1 to PDVSA, a government-owned petroleum company in Venezuela. (Sabzali, Trial Tr. at 450:12-  
2 20.) As both Jensen and Sabzali testified, Thermax had incentives to buy systems from Basin  
3 regardless of whether PDVSA ever ordered systems from Thermax; namely, Thermax had an  
4 interest in licensing and marketing Basin's technology in Asian markets. (*Id.* at 470:4-10; Jensen,  
5 Trial Tr. at 870:20-871:2, 871:13-21.)

6 On September 25, 2006, Sabzali e-mailed a letter (the "September 25 Letter") to Jensen,  
7 stating that Thermax would purchase the Basin systems subject to several "caveats" and "T&C's"  
8 (terms and conditions). (Sabzali, Trial Tr. at 451:17-452:14; Ex. 512 (9/25/06 Letter).) Attached to  
9 the e-mail was a two-page unsigned letter from Sabzali. The "caveats" were listed on the first page  
10 of the September 25 Letter and "[t]he details of the system we will be ordering are on page 2."  
11 (Ex. 512 (9/25/06 Letter).) The first caveat was that Thermax's purchase order would be  
12 "predicated on Thermax Inc. receiving a similar order from PDVSA." The second caveat was that,  
13 if Thermax did not receive a PDVSA purchase order by November 30, 2006, Thermax would  
14 cancel its purchase order with Basin and replace it with a new order from Thermax. (*Id.*, ¶ 2 at  
15 SECLA3478-01642153.) Sabzali described this second point as an "escape clause" for Thermax,  
16 and testified that it was an important part of the deal for Thermax. (Sabzali, Trial Tr. at 476:11-  
17 15.) In the cover e-mail to the September 25 Letter, Sabzali asked Jensen to confirm by reply e-  
18 mail the "agreements with caveats and Ts&C's on the PO." (Ex. 512 (9/25/06 Letter).) Sabzali  
19 testified that he and his superior, Shastri, the President of Thermax, were expecting written  
20 confirmation from Jensen. (Sabzali, Trial Tr. at 474:6-23, 476:16-18, 477:12-478:7.) Sabzali also  
21 testified that he never received written confirmation affirming the "caveats." (Sabzali, Trial Tr. at  
22 474:475:3.).

23 Jensen forwarded the September 25 Letter to Pat Kelly, Basin's General Manager. (Jensen,  
24 Trial Tr. at 878:22-879:10, 964:2-14; Ex. 537 (9/26/06 E-mail).) Kelly discussed the September 25  
25 Letter with Jensen, pointed out the contingency caveats on page one, and said that Basin could not  
26 agree to any of them. (Jensen, Trial Tr. at 879:13-25.) Realizing that he had received a contingent  
27 offer, Jensen called Sabzali and rejected it. (Jensen, Trial Tr. at 880:23-881:11.) Jensen told  
28 Sabzali that if Thermax wanted to do business with Basin, Thermax would have to send a clean

1 purchase order. (Jensen, Trial Tr. at 881:1-8.) On September 28, 2006, Thermax's Finance Unit,  
2 not the Sales Department, delivered such a purchase order ("Purchase Order"), *i.e.*, one that did  
3 not include any of the caveats that Kelly and Jensen had rejected. (Ex. 500 (Purchase Order);  
4 Jensen, Trial Tr. at 966:8-13.) The purchase order attached as an addendum a version of page 2 of  
5 the September 25 Letter, which described "[t]he details of the system" that Thermax was ordering,  
6 such as the size and type of systems to be provided and the price. (Ex. 500 (Purchase Order).)

7 The addendum listed the shipping date as "TBA" (or "to be advised") and the "T&C" as  
8 "TBA" and "Agreed that the T&C to Basin will reflect the T&C's on PDVSA's PO to Thermax  
9 Inc." (Ex. 500 (Purchase Order at SEC-LA3478-01643054.) Because the Purchase Order did not  
10 contain the caveats of the September 25 Letter, Jensen understood that the Purchase Order to be  
11 "clean" and free of contingencies. (Jensen, Trial Tr. at 883:23-884:9 (describing Purchase Order as  
12 "noncontingent").)

13 Sabzali testified that Jensen agreed to the caveats in at least one phone conversation in  
14 September. (Sabzali, Trial Tr. at 477:1-16.) Sabzali's testimony on this point is not credible given  
15 that: (1) Sabzali asked for Jensen's written confirmation of the terms of the September 25 Letter  
16 (including the "escape clause") and never received such confirmation; (2) the Purchase Order did  
17 not attach any of caveats of the September 25 Letter; (3) Sabzali confirmed that there was no  
18 "escape clause" in the Purchase Order, and; (4) despite never receiving a purchase order from  
19 PDVSA, Thermax did not exercise the "escape clause" provision of the September 25 Letter, and  
20 Sabzali had no explanation for the failure to exercise the "escape clause." (*Id.* at 474:17-475:3;  
21 476:11-18; 478:8-17; 485:13-19; 488:22-489:3.)

22 Pat Kelly, the General Manager of Basin, provided corroborating testimony that Jensen  
23 had rejected the "caveats" in the September 25 Letter and that the Purchase Order was non  
24 contingent. Kelly was a credible witness. Prior to coming to Basin, Kelly had been a general  
25 manager of various divisions at Osmonics. (Kelly, Trial Tr. at 1215:17-24.) He had dealt with  
26 manufacturing purchase orders for many years. (*Id.* at 1215:18-21, 1216:5-12, 1217:16-20.) Kelly  
27 confirmed that, when he saw the September 25 Letter, he informed Jensen that it contained  
28 impermissible contingencies and that it was unacceptable. (*Id.* at 1221:7- 1223:18.) When Kelly

1 saw the Purchase Order, however, he believed, based on his experience, it was a valid Purchase  
 2 Order, including the “TBA” and “T&Cs” provisions of the addendum. (*Id.* at 1224:23-1226:23,  
 3 1228:17-1229:7, 1230:4-1231:20.) It was common for shipping dates “to be arranged” later by  
 4 purchasers of Basin units given that extensive preparation at the well-head site might be required.  
 5 (*Id.* at 1229:1-1230:3.) Furthermore, unspecified “terms and conditions” relating to shipment, such  
 6 as preparation of units for ocean-going travel, did not preclude Basin from beginning construction  
 7 on the units. (*Id.* at 1231:13-20; Tekulve, Trial Tr. at 187:13-17.) After Kelly received the  
 8 Purchase Order, he directed the construction and completion of the units in Basin’s shop. (Kelly,  
 9 Trial Tr. at 1226:24-1227:6, 1227:19-1228:12, 1231:23-1232:7.)

10 On September 28, 2006, Tekulve received the Thermax Purchase Order. It stated a total  
 11 purchase price of \$860,320 and was signed by Thermax’s Finance Manager, Heather Boulton.  
 12 Based on the Purchase Order, Basin began recording revenue in the third quarter of 2006 using the  
 13 percentage of completion revenue recognition method. (Ex. 30 (9/28/2006 e-mail from Pat Kelly  
 14 to Basin personnel initiating construction of units according to specifications in Thermax PO);  
 15 Kelly, Trial Tr. at 1227:19-1228:12; Tekulve, Trial Tr. at 1313:4-6; Holder, Trial Tr. at 1466:20-  
 16 23.) The percentage of completion method of accounting is widely accepted for orders of custom  
 17 equipment that require time to construct. (Holder, Trial Tr. at 1466:24-1468:2.) Under this  
 18 method, revenue is recorded as the equipment is built. Basin’s use of the this accounting  
 19 methodology for the Thermax order was reasonable. (Holder, Trial Tr. at 1466:24-1468:2.)

20 Basin’s recognition of revenue on the Thermax sale was consistent with GAAP. (Holder,  
 21 Trial Tr. at 1470:2-6.) Thermax’s Purchase Order constituted “persuasive evidence of an  
 22 arrangement,” as required under SAB 104. (Ex. 500 Thermax P.O.; Tekulve, Trial Tr. at 350:7-8;  
 23 Holder, Trial Tr. at 1466:8- 17.) The price for the sale was fixed by the terms of the Purchase  
 24 Order. (Ex. 500, (9/28/2006 E-mail from H. Boulton to pljensen@basinwater.com, attaching  
 25 Thermax Purchase Order.) There was also sufficient evidence to conclude that collectability from  
 26 Thermax was reasonably assured based on its status as a large multinational corporation. (Tekulve,  
 27 Trial Tr. at 349:9-23, 1312:13-25; Holder, Trial Tr. at 1468:7-14.) This transaction had economic  
 28 substance.

1 Tekulve reasonably relied on the professional advice of Basin's auditors in deciding to  
2 recognize revenue from the Thermax transaction. (Tekulve, trial Tr. at 1315:2-15.) Singer  
3 performed a quarterly review of Basin's financial statements for the third quarter of 2006. (Ex.  
4 630 at SEC-LA3478-01646017 (Singer Audit Report for 2006); Ex. 236 at SEC-LA3478-  
5 00003247 (Singer Audit Report for 2007); Ward-Cline, Trial Tr. at 1265:18-22, 1268:10-25.)  
6 Singer received a copy of the Thermax Purchase Order in connection with that review. (Ex. 874 at  
7 SEC-LA3478-01268790 (Singer work paper identifying Thermax transaction and relevant terms  
8 from the PO); Hayn, Trial Tr. at 1110:10-1112:1.)

9 Singer also reviewed the Thermax Purchase order in connection with its audit of Basin's  
10 year-end 2006 Financial statements. Singer's work papers for the year-end 2006 audit reflect that  
11 Singer specifically identified the "TBA" terms of the Thermax transaction. (Ex. 874 at SEC  
12 LA3478-01268790 (Singer work paper identifying Thermax transaction and relevant terms from  
13 the PO).) (Tekulve, Trial Tr. at 352:17-22.) No one at Basin misled Singer about the Thermax  
14 transaction or failed to provide requested information. (Tekulve, Trial Tr. at 352:14-16; Ward-  
15 Cline, Trial Tr. at 1272:1-12; Fryling, Trial Tr. at 1374:3-1375:3; Gupta, Trial Tr. at 1405:11-15.)  
16 Singer raised no concerns about the Thermax transaction and issued an unqualified report for the  
17 third quarter 2006 as well as a clean audit opinion for Basin's 2006 year-end financial statements.  
18 (Ex. 630 at SEC-LA3478-01646017 (Singer Audit Report for 2006); Holder, Trial Tr. at 1459:9-  
19 14, 1469:5-9; Tekulve, Trial Tr. at 1315:5-13; Fryling, Trial Tr. at 1374:3-1375:3; Gupta, Trial Tr.  
20 at 1405:11-23.)

21 Thermax ultimately refused to make good on its September 28, 2006 Purchase Order.  
22 (Tekulve, Trial Tr. at 1316:19-1317:8, 1317:21-1318:5.) After notifying Singer that this debt was  
23 unlikely to be paid, Basin took a reserve in the third quarter of 2007 against the revenues  
24 previously recognized from the Thermax transaction. (Tekulve, Trial Tr. at 1316:19-1317:12.)

25 Tekulve could not have foreseen that Thermax would refuse to honor its Purchase Order  
26 when deciding to recognize revenue in 2006. He was not even aware of the potential "caveats" to  
27 Thermax's Purchase Order until April 2007. (Tekulve, Trial Tr. at 185:10-186:11.) Tekulve did  
28 not violate GAAP when he recognized revenue for the Thermax transaction. (Tekulve, Trial Tr. at

1 1349:5-21.)

2 **c. Stark Takes over as CEO**

3 Before the next transactions at issue in this case were consummated, a change in leadership  
4 at Basin occurred as Stark took over for Jensen as CEO. Soon after Basin went public in May  
5 2006, Jensen decided that he needed to replace himself as the operational head of the company  
6 with someone who had greater managerial experience due to the planned nationwide expansion of  
7 Basin. (Jensen, Trial Tr. at 967:21-968:20.) In June, one month after the IPO, Jensen approached  
8 Michael Stark about joining Basin because Stark recently had served as CEO of the North  
9 American division of Veolia, the world's largest water utility and services company. (*Id.*, 967:3-  
10 11, 969:15-970:10; Stark, Trial Tr. at 583:24-584:19, 710:4-20, 711:7-11; Solar, Trial Tr. at  
11 1158:1-14.)

12 In recruiting Stark to Basin, Jensen made clear his intention that Stark would run the  
13 Company. (Jensen, Trial Tr. at 968:21-969:14; Solar, Trial Tr. at 1158:1-14; Stark, Trial Tr. at  
14 586:13-24, 712:3-11, 716:15-717:5; Ex. 901 (2008 Waterworld Article).) As Stark explained to a  
15 water industry reporter:

16 “When he and I first talked about this, I said, ‘Peter, you know there can’t be two roosters  
17 in this hen house. I’m used to running pretty big businesses. This is a pretty small business.  
18 That’s going to be enough of a challenge for me. I can’t have you walking around doing  
19 what you do. There has got to be one person.’” Peter Jensen says: “‘Mike, I don’t want to  
20 do it. It is yours.’ And when he became a CEO and made me COO, until the day he  
21 resigned as CEO and I became CEO he never, ever argued with me about anything in the  
22 market or anything about operations.” (Stark, Trial Tr. at 718:17-719:21; Ex. 901 (2008  
23 Waterworld Article) at 901-6.)

24 Stark started at Basin in October 2006 as President and Chief Operating Officer. (Solar,  
25 Trial Tr. at 1158:1-14, 1164:9-23; Stark, Trial Tr. at 711:12-15.) Stark’s influence over Basin was  
26 immediate. Pat Kelly recalled that “Mike Stark was running Basin from Day One.” (Kelly, Trial  
27 Tr. at 1244:2-11.) Even though Jensen retained the title of CEO, Tekulve testified, “when Stark  
28 was brought on board, he essentially took command of the company.” (Tekulve, Trial Tr. at 191:5-

11.) By his own account, Stark was responsible for sales and for the operating system. (Stark, Trial Tr. at 587:13-17.) While Stark denied running the finance department in 2007 (Stark, Trial Tr. at 587:18-20), Tekulve testified that he began reporting directly to Stark as soon as Stark joined Basin. (Tekulve, Trial Tr. at 388:18-389:5 (Stark was boss at Basin for 2007 and took over operation of the company shortly after he was hired).) From his vantage point on the Board, Keith Solar also observed Stark exerting immediate control over the company. (Solar, Trial Tr. at 1166:14-20, 1164:9-23, 1165:2-4, 1168:9-23, 1172:20-1173:9, 1176:13-1178:15; Ex. 1396 (3/22/07 Board Minutes) at 1396-3; Ex. 1574 (5/9 and 5/10/07 Board Minutes) at 1574-4; Ex. 813 (5/14/07 Earnings Call); Ex. 832 (8/14/07 Earnings Call).)

After Jensen turned the reins of Basin over to Stark and his team of professionals, Jensen devoted himself to discrete projects, including the development of the assets of the West Riverside Canal, also known as Empire Water. (Jensen, Trial Tr. at 977:2-978:15; Stark, Trial Tr. at 725:10-726:14.) In February 2008, Jensen resigned as CEO of Basin and focused, through Empire Water, on his interest in developing the canal rights full time. (Jensen, Trial Tr. at 981:16-982:10; Stark, Trial Tr. at 749:6-13; Solar, Trial Tr. at 1177:25-1178:11.) On March 11, 2008, Jensen resigned from the Basin Board. (Final Pretrial Conf. Order (Doc. No. 193), ¶5(a) at 4.)

#### **d. VL Capital Transaction**

Stark pursued a new business strategy for Basin. (Stark, Trial Tr. at (Ex. 813 (Q1 2007 analyst call); Tekulve, Trial Tr. at 1318:7-10; Fryling, Trial Tr. at 1377:22-1378:5.) Stark's plan was for Basin to sell its water treatment units using third-party financing after they were leased to a municipality. (Stark, Trial Tr. at 616:7-618:15; Ex. 984 (Q4 2006 analyst call); Ex. 813 (Q1 2007 analyst call); Tekulve, Trial Tr. at 1318:11-21.) In analyst calls, Stark openly stated his intention to engage in third-party financed sales as a means of generating both cash and revenue. (Ex. 984 (Q4 2006 analyst call); Ex. 813 (Q1 2007 analyst call).)

Stark had a close and longstanding personal and business relationship with Charles Litt, who specialized in arranging financing deals of this kind. (Ex. 777 (11/24/2006 e-mail from Stark to Litt); Ex. 781 (2/29/2007 e-mail Stark to Jackson Re: Charlie); Ex. 782 (6/21/2007 e-mail Stark to Litt Re: CCH – Great News); Tekulve, Trial Tr. at 196:2-10, 371:15-25, 1319:12-20.) Within a



1 month of starting at Basin, Stark directed Tekulve to work with Litt to secure sources of financing  
2 for the sale of Basin units. (Exh 797 (11/10/2006 e-mail Stark to Litt Re: Heritage); Tekulve, Trial  
3 Tr. at 1319:21-1320:2.)

4 In the Spring of 2007, Stark asked for a report on Tekulve's efforts to locate third-party  
5 financing. Tekulve provided a discouraging report. Stark then forcefully urged Tekulve to work  
6 with Litt on this project.

7 During Spring 2007, Stark committed to Basin's Board of Directors and to the public  
8 markets that third-party financed sales would take place during the second quarter 2007. (Ex. 764  
9 (4/11/2007 e-mail from Stark to the Board); Stark, Trial Tr. at 654:8-25.) For example, in May  
10 2007, Stark told analysts that Basin would complete third-party financed sales of its units by the  
11 end of the second quarter. (Ex. 813 (Q1 2007 analyst call); Stark, Trial Tr. at 660:11-661:6.)

12 In emails sent during May and June 2007, Stark pushed Litt with greater urgency to find a  
13 source of financing and arrange a sale by quarter end. On May 1, 2007, for example, Stark wrote  
14 to Litt, "These must be financed and done deals before [Q2] end. We have no room for error." (Ex.  
15 812.) On May 3, 2007, Stark wrote, "I need this badly." (Ex. 816.) On May 19, 2007, five days  
16 after the May analyst call, he wrote to Litt, "I really really really need to get those systems  
17 placed." (Ex. 815.)

18 By May 2007, Stark had concluded that Tekulve either would not be able to get the  
19 financing done or would not be able to get it done within the necessary time frame. At that point,  
20 Stark was relying on Litt to conclude the deal by quarter end. (Stark, Trial Tr. at 662:17-664:10.)

21 Litt kept Stark and Tekulve apprised of the potential deals he identified. On May 22, 2007,  
22 Stark asked Tekulve to walk him through spreadsheets analyzing various deal scenarios Litt was  
23 developing. (Ex. 819.)

24 On June 21, 2007, Litt relayed to Stark and Tekulve the "great news" that a European  
25 financing group called CCH was willing to finance a \$5 million sale of Basin units. (Ex. 782;  
26 Stark, Trial Tr. at 669:8-24.) Although Tekulve was unfamiliar with CCH, Litt had previously  
27 done business with that organization. (Ex. 801 (11/12/2006 e-mail string between Stark and Litt  
28 referencing CCH.) Stark, too, in November 2006, had expressed an interest in having CCH

1 provide financing to Basin. (Stark, Trial Tr. at 640:13-641:4.) Later the same day, June 21, 2007,  
2 Stark and Litt discussed the proposed CCH transaction as well as proposed transaction with  
3 Lakeland Bank. (Ex. 824 (good news e-mail); Ex. 822 (more good news email).) In a private e-  
4 mail to Litt, Stark asked “What’s the best deal out there now . . . ?” Litt recommended CCH. (Ex.  
5 826 (Stark to Litt re recommendation); Ex. 827 (Litt recommendation).)

6 The sale was completed on June 30, 2007. Tekulve testified that Basin’s goals for entering  
7 into the sale included the following: (1) to establish a relationship with a lending institution for  
8 purposes of future financing transactions; (2) to create a deal template for future third-party  
9 financed sales; (3) to establish a financing mechanism by which Basin could expand in the  
10 marketplace without using its own cash; (4) to generate cash, to the extent possible; and (5) to  
11 generate revenue, to the extent possible.

12 Under the terms of the transaction, Basin sold ten leased units to a special purpose entity  
13 called VL Capital (“VLC”) for \$5 million, less the present value of taxes and insurance for the  
14 units. (Ex. 824 -(6/21/2007 e-mail Stark to Litt Re: CCH – Great News); Ex. 112 (6/29/2007  
15 Equipment Purchase Commitment Letter).) CCH would provide the funding for the SPE to  
16 acquire the units and would recover the stand-by fees from the municipalities. (Ex. 825 (CCH  
17 commitment letter).

18 Litt told Tekulve that the SPE was being formed at CCH’s request and for its benefit.  
19 (Tekulve, Trial Tr. at 376:3-22.) Tekulve viewed VLC as an intermediary for CCH. (Ex. 825  
20 (CCH commitment letter).) Litt arranged for his associate Lloyd Ward, an attorney in Dallas,  
21 Texas, to form and manage VLC. (Ex.1640 (Operating Agreement for VLC ); Ward, Trial Tr. at  
22 491:25-492:21; Tekulve, Trial Tr. at 201:25-202:3.) Tekulve had never done a deal involving an  
23 SPE before but he trusted Litt, Stark’s hand-picked financial consultant, to recommend an  
24 appropriate deal structure. (Tekulve, Trial Tr. at 375:20-377:7).

25 Based on Tekulve’s analysis of the deal, he concluded that using an SPE did not  
26 disadvantage Basin. (Tekulve, Trial Tr. 1339:-1342:5.)

27 Basin, VLC, and CCH entered into letter agreements on June 29, 2007 that established the  
28 material terms of the sale and the financing. (Exh 658 - 6/27/2007 VLC Equipment Purchase

1 Commitment.) Latham subsequently assisted Basin with preparing the formal contracts associated  
2 with this transaction. (Gupta, Trial Tr. at 1402:17-24; Tekulve, Trial Tr. at 356:25-357:18.).  
3 Formal documentation of the deal was completed in September 2007. (Ex. 108 (letter enclosing  
4 final documentation.)

5 In May 2007, Tekulve met with Singer to alert them that Basin was planning a transaction  
6 different than those it had done in the past. On July 11, 2007, Tekulve met with Singer auditors  
7 Gale Moore and Ian Lawson to discuss Basin's financial results for the second quarter of 2007 and  
8 the VLC sale in particular. (Ex. 877 (7/10/2007 e-mail string between Gale Moore and Doug  
9 Hansen arranging meeting); Tekulve, Trial Tr. at 362:9-15.)

10 In July and August 2007, Singer undertook an extensive review of the VLC transaction.  
11 This review included:

- 12 • reviewing a 7-page Basin-prepared white paper describing the sale and analyzing the  
13 company's proposed accounting treatment. (Ex. 881 (8/7/2007 e-mail string between Gale  
14 Moore and Doug Hansen discussing topics to be included in white paper); (Ex. 921  
15 (8/8/2007 e-mail from D. Hansen to T. Tekulve Re: Revised VLC Memo, attaching  
16 8/8/2007 Memorandum from D. Hansen to File Re: Equipment Sale to VL Capital, LLC);  
17 Tekulve, Trial Tr. at 243:7-14.)
- 18 • reviewing the VLC agreement; (Ex. 882 (e-mail string between Hansen and  
19 Moore discussing whether agreement was binding); Tekulve, Trial Tr. at  
20 1323:22-1324:2.)
- 21 • reviewing a confirmation letter from Ward regarding the agreement; (Ex. 709  
22 (8/7/2007 letter from Lloyd Ward to Basin confirming binding agreement to  
23 purchase units).)
- 24 • reviewing a confirmation letter from CCH regarding the agreement; (Ex. 710  
25 (8/7/2007 letter from CCH to VLC confirming binding agreement to pledge  
26 assets for CCH's purchase of units from Basin).)
- 27 • receiving an opinion from Divikar Gupta of Latham & Watkins about the  
28 binding nature of the letter agreement between VLC and Basin; (Ex. 883:

1 Singer workpaper noting that Div Gupta confirmed via phone that the letter  
 2 agreement was legally binding); Ex. 882 (8/7/2007 e-mail from Gale Moore  
 3 to Doug Hansen indicating that a written legal opinion was not needed).)  
 4 • reviewing the accounting for VLC with Basin's Audit Committee; (Ex. 619  
 5 (8/9/2007 Minutes of a Telephonic Meeting of the Audit Committee of the  
 6 Board of Directors of Basin, Inc.)  
 7 • recommending expanded disclosure of the transaction in the company's  
 8 Form 10-Q. (Ex. 882 (8/7/2007 e-mail from G. Moore to D. Hansen Re:  
 9 VLC Transaction; Tekulve, Trial Tr. at 252:22-253:9, 364:3-7.)

10 Basin's Audit Committee met on August 9, 2007 to review the financial results for the  
 11 second quarter and the draft 10-Q. The participants at that meeting included representatives of  
 12 management (President/COO Stark, CFO Tekulve, Director of Finance Doug Hansen); Basin's  
 13 General Counsel, Scott Hamilton; Basin's outside counsel, Divikar Gupta of Latham & Watkins;  
 14 the members of the Audit Committee, led by Victor Fryling; and Basin's independent audit or  
 15 Gale Moore of Singer. Peter Jensen did not attend this meeting. (Ex. 619 (8/9/07 Audit Minutes) at  
 16 SEC-LA3478-0214705.)

17 At that meeting, the Audit Committee conducted a "lengthy discussion" of the VLC  
 18 transaction. (Ex. 619 (8/9/2007 Minutes of a Telephonic Meeting of the Audit Committee of the  
 19 Board of Directors of Basin, Inc.); Fryling, Trial Tr. at 1380:8-1382:5; Tekulve, Trial Tr. at 363:8-  
 20 15.) Moore spoke to the Audit Committee and specifically addressed the "accounting for the VLC  
 21 transaction." Members of the Audit Committee had an opportunity to question Moore about the  
 22 draft 10-Q. Basin's Audit Committee approved of the VLC deal because it set the stage for future  
 23 third-party financed transactions. (Ex. 619 (8/9/2007 minutes); (Ex. 832 (8/14/2007 Final  
 24 Transcript of BWTR - Q2 2007 Basin Earnings Conference Call).)

25 The evidence was uncontroverted that Jensen had no involvement whatsoever with the  
 26 negotiation, accounting, or announcement of the VLC or WSS transactions. He had no more  
 27 knowledge of this transaction than any other member of the Board of Directors. (Tekulve, Trial Tr.  
 28 at 212:21-213:21, 216:22-217:14.) Jensen was not present at the Audit Committee meeting where

1 the VLC transaction was vetted. (Exhibit 619 (8/9/2007 Audit Committee Minutes) at SEC  
 2 LA3478-01214705-06.) Yet, Basin's financial and operational team - Stark, Hamilton, Tekulve,  
 3 Hansen, Moore, and Gupta from Latham - were all in attendance. (Ex. 619 (8/9/2007 Audit  
 4 Committee Minutes) at SEC-LA3478-01214705.) Stark, not Jensen, signed the management  
 5 representation letters to Singer regarding the VLC and WSS transactions. (Stark, Trial Tr. At  
 6 731:23-736:21; Ex. 641 (8/13/07 Management Rep. Letter) at 64-4; Ex. 642 (11/13/07  
 7 Management Rep. Letter) at 642-5; Ex. 643 (3/17/08 Management Rep. Letter) at 643-6.) Stark,  
 8 and not Jensen, certified Basin's audited financial statements for 2007 in its 2007 10-K filing.  
 9 (Stark, Trial Tr. at 737:11-738:17; Ex. 236 (Basin 10-K) at SEC-LA3478-00003285 and SEC  
 10 LA3478-00003287.) Lloyd Ward, the Manager and sole member of VLC, testified that he did not  
 11 even know who Peter Jensen was. (Ward, Trial Tr. at 541:4-6.)

12 The VLC transaction had economic substance. (Stark, Trial Tr. at 673:21-647-19; Gupta,  
 13 Trial Tr. at 1411:4-15; Tekulve, Trial Tr. at 1323:5-21, 364:23-365:4). Basin entered into the  
 14 transaction for legitimate business reasons including, among other things, to establish an ongoing  
 15 relationship with a lender and to establish a model for future third-party financed sale. (Exh. 832  
 16 (Q2 2007 analyst call); Stark, Trial Tr. at 685:9-23; Tekulve, Trial Tr. at 1322:6-1323:4.) Stark  
 17 and Ward, witnesses for the SEC, testified that they considered the transaction legitimate. Ward  
 18 confirmed the transaction to Singer in August 2007 and again in March 2008. The VLC  
 19 transaction was approved after review by Basin's management, its Audit Committee, its outside  
 20 counsel, its internal counsel, and an exhaustive review by Singer. (Stark, Trial Tr. at 683:19-  
 21 684:16; Fryling, Trial Tr. at 1380:8-1383:2; Tekulve, Trial Tr. at 364:23-366:9).

22 Singer was provided with all relevant material and information related to the VLC  
 23 transaction. No one testified to the contrary. As noted above, Singer discussed the accounting  
 24 treatment for the VLC transaction at the August 9, 2007 Audit Committee meeting. (Ex. 619  
 25 (8/9/2007 minutes); Fryling, Trial Tr. at 1380:8-1383:2.) Singer identified no issues of concern  
 26 about the transaction to the Audit Committee. (Exh. 619 (8/9/2007 minutes); Fryling, Trial Tr. at  
 27 1380:8-1383:2.) Nor did Singer indicate any disputes with Basin's management or difficulties  
 28 reviewing the transaction. (Exh. 619 (8/9/2007 minutes); Fryling, Trial Tr. at 1380:8-1383:2;

1 Gupta, Trial Tr. at 1405:11-15.)

2 The June 29, 2007 Letter Agreement between the parties constituted “persuasive evidence  
3 of an arrangement,” as required under SAB 104. (Tekulve, Trial Tr. at 208:20-25; Holder, Trial  
4 Tr. at 1470:13-18.) Ownership of the units was transferred to VLC, and the price for the sale was  
5 determinable based on the terms of the Letter Agreement and a present value calculation of the tax  
6 and insurance costs. (Tekulve, Trial Tr. at 209:17-210:5; Holder, Trial Tr. at 1471:4-21.) There  
7 was also sufficient evidence to conclude that collectability from VLC was reasonably assured  
8 based on its financing agreement with CCH and the standby fees it would receive from  
9 municipalities. (Tekulve, Trial Tr. at 211:5-212:8; Holder, Trial Tr. at 1471:24-1472:12.) Under  
10 these circumstances, Tekulve’s decision to recognize revenue from the VLC transaction was  
11 reasonable under SAB 104. (Holder, Trial Tr. at 1470:13-1472:12; Ex. 1764 (SAB 104 factors  
12 applied to VLC transaction).)

13 The accounting for VLC was incorrect because of Basin’s failure to apply FIN 46(R). The  
14 testimony showed that FIN 46(R) is a relatively new and complex accounting rule that changed  
15 the conceptual framework for consolidation. (Holder, Trial Tr. at 1475:5-1476:8.) Tekulve had no  
16 experience applying FIN 46(R) at the time of the VLC transaction. (Tekulve, Trial Tr. at 1340:10  
17 12.) CFOs are not required to be fluent with every accounting rule under GAAP. (Holder, Trial Tr.  
18 at 1455:22-24.) No one at Basin or Singer recognized the potential application of FIN 46(R) at the  
19 time revenue was recognized on VLC. (Tekulve, Trial Tr. at 1340:20-25, 1341:16-21; Gupta, Trial  
20 Tr. at 1408:22-1409-11; 1430:12-24.) Given the scrutiny applied to VLC from all quarters,  
21 Tekulve’s own diligence both in establishing accounting and finance processes at Basin and in  
22 applying those processes to VLC, the rule’s novel and recently adopted approach to consolidation  
23 and the consequent difficulty in spotting its potential application, and the universal failure of  
24 accounting professionals involved at the time to recognize FIN 46(R) as a potential issue, the  
25 Court concludes that Tekulve’s failure to apply FIN 46(R) did not result from any lack of  
26 diligence or professional care.

27 Tekulve reasonably relied on the professional advice of Basin’s auditors in deciding to  
28 recognize revenue from the VLC transaction. (Tekulve, Trial Tr. at 1323:22-1324:10, 1324:19-

1 1325:3; Holder, Trial Tr. at 1473:4-22.) Singer performed an extensive review of the transaction,  
 2 including verifying information with third party sources, and affirmatively approved the  
 3 accounting for the transaction to Basin's audit committee. (Ex. 619 (8/9/2007 minutes of Basin  
 4 Audit Committee meeting); Fryling, Trial Tr. at 1382:13-25) Singer approved the revenue from  
 5 and the disclosure of the transaction in the second quarter 2007 10-Q. Further, Singer issued a  
 6 clean audit opinion for Basin's 2007 year-end financial statements. (Ex. 236 at SEC-LA3427-  
 7 0003247 (2007 Audit Report); Holder, Trial Tr. at 1473:4-21.) No one at Basin misled Singer  
 8 about the VLC transaction or failed to provide requested information. (Tekulve, Trial Tr. at 387:2-  
 9 5; 1305:2-8; Ward-Cline, Trial Tr. at 1272:1-12; Fryling, Trial Tr. at 1373:6-9.) Tekulve's  
 10 decision to recognize revenue on VLC at the end of the second quarter of 2007 was not negligent,  
 11 reckless, or fraudulent.

#### 12 **e. Subsequent SPE Transactions**

13 After Basin filed its Form 10-Q for the second quarter of 2007, Stark led an analyst call in  
 14 which he discussed the VLC deal. (Exh. 832 (Q2 2007 analyst call); Stark, Trial Tr. at 685:13-23.)  
 15 Stark noted that although the terms of the VLC sale were not ideal, the transaction was valuable to  
 16 Basin as a model for future third-party financed sales. (Ex. 832 (Q2 2007 analyst call); Stark, Trial  
 17 Tr. at 685:13-23.)

18 After the extensive review of the first VLC deal, Tekulve believed he was authorized to  
 19 proceed with transactions modeled after VLC. (Exh. 832, p. 11 OR p.018/033 (Q2 2007 analyst  
 20 call re "mechanism in place"); Tekulve, Trial Tr. 1338:17-23.) With Litt's help, and Stark's  
 21 knowledge and approval, Tekulve completed additional third-party financed sales that mirrored  
 22 the economic terms of and accounting for VLC. (Tekulve, Trial Tr. at 1335:19-21, 1336:11-17,  
 23 1337:2-15; Stark Trial Tr. at 686:11-687:15.) The only significant variation in the later SPE sales  
 24 was that some involved water treatment units that had not yet been built. (Tekulve, Trial Tr. at  
 25 1336:2-8; Holder, Trial Tr. at 1480:18-22.) On those sales, Basin recognized revenue on a  
 26 percentage-of-completion basis. (Tekulve, Trial Tr. at 316:9; Holder, Trial Tr. at 1480:18-23.)

27 In the third quarter of 2007, Basin agreed to construct and lease to the City of Cottonwood,  
 28 Arizona 17 new water treatment units. (Ex. 731 (9/10/2007 Letter Agreement between WSS and



1 Basin re Equipment Purchase – Cottonwood Project, attaching Equipment Lease Agreement and  
2 Water Services Agreement); Tekulve, Trial Tr. at 377:8-378:14.)<sup>4</sup> Using the VLC template, Basin  
3 sold these units to Water Services Solutions, LLC (“WSS”), an SPE formed by Lloyd Ward.  
4 National City Energy Capital (“NCEC”) financed the sale to WSS. (Exh. 213 (Nat City  
5 Commitment Letter).) Under its agreement with WSS, Basin sold the units for \$3,845,073,  
6 including a \$1,506,140 down payment payable when the units were accepted by Cottonwood.  
7 (Exh. 731 (WSS Letter agreement).) Litt arranged for NCEC to finance the sale through a loan to  
8 WSS and told Tekulve that, like VLC, WSS was formed for the benefit of NCEC. (Tekulve, Trial  
9 Tr. at 273:15-274:14.)

10 At Singer’s request, Hansen prepared and Tekulve reviewed and edited another white  
11 paper describing the WSS transaction and analyzing the company’s proposed accounting  
12 treatment. (Ex. 894 (10/31/2007 Memorandum D. Hansen to File Re: Equipment Sale to Water  
13 Services Solutions, LLC).) During its review of Basin’s third-quarter financial statements, Singer  
14 reviewed the white paper and spoke with Ward and Litt regarding the WSS transaction. (Ex. 895  
15 (Singer WP re WSS transaction).) Following its review, Singer agreed with the accounting for  
16 WSS. (Tekulve, Trial Tr. at 387:7-9.)

17 In the fourth quarter of 2007, Basin entered into two additional transactions modeled after  
18 VLC. (Tekulve, Trial Tr. at 1335:19-1336:1.) On December 28, 2007, Basin sold a unit to VLC  
19 that it had recently contracted to manufacture and lease to Cal Water. (Ex. 145 (12/31/2007  
20 between Basin and VLC re CW65); Tekulve, Trial Tr. at 316:22-317:10.) That same month Basin  
21 sold another unit to WSS that it had contracted to build and lease to the East Valley Water District.  
22 (Ex. 121 (12/26/2007 Agreement between Basin and WSS re EVWD); Tekulve, Trial Tr. at  
23 311:10-21.)

24 In spring 2008, Singer audited Basin’s 2007 year-end financial statements, which included  
25 all of the VLC and WSS transactions. (Ex. 236 at SECLA3478-00003247 (Singer Audit Report  
26 for 2007).) Singer received audit confirmations from Lloyd Ward on behalf of WSS and VLC.  
27 (Ex. 893 (3/5/2008 letter from Lloyd Ward to Singer confirming economic terms of WSS I  
28 transaction); Ex. 900 (3/5/2008 letter from Lloyd Ward to Singer confirming economic terms of

1 WSS II transaction); Ex. 899 (2/15/2008 confirmation from L. Ward-Cline re VLC transactions).)  
2 At the conclusion of the audit, Singer rendered a clean audit opinion. (Ex. 236 at SEC-LA3478  
3 00003247 (Singer Audit Report for 2007); Holder Trial Tr. at 1482:4-6.)

4 Similar to Jensen's lack of involvement in the VLC transaction, the evidence also was  
5 uncontroverted that Jensen had no involvement whatsoever with the negotiation, accounting or  
6 announcement of any subsequent SPE transactions. (Hayn, Trial Tr. at 1115:19-1116:17.) With  
7 respect to Jensen's alleged liability on the WSS transaction, the SEC introduced evidence showing  
8 only that Jensen was aware of the transaction. (Jensen, Trial Tr. at 912:12-18, 914:5-21.) No  
9 evidence was introduced showing that Jensen had any more knowledge of the transaction than  
10 what was disclosed in Basin's 10-Q filing for the third quarter of 2007.

11 The two WSS transactions and the second VLC transaction had economic substance.  
12 These transactions had substantially the same economic structure as the first VLC transaction,  
13 which had been thoroughly reviewed and approved by Basin management, its Audit Committee,  
14 its General Counsel, its outside counsel, and its auditors. (Holder, Trial Tr. at 1473:4-22, 1480:1-4,  
15 1482:7-12.) The economic basis for these transactions was not disputed at the time they were  
16 finalized, and no events since that time suggest that the true nature of these transactions was  
17 concealed. (Tekulve, Trial Tr. at 385:19-386:14, 1343:7-22.)

18 Tekulve's decisions to recognize revenue from the WSS transactions and the second VLC  
19 transaction were also reasonable under SAB 104. (Holder, Trial Tr. at 1480:24-1481:3, 1482:7-  
20 15.) The material terms for each of these transactions were documented in letter agreements  
21 between the parties that constituted "persuasive evidence of an arrangement." (Ex. 145  
22 (12/31/2007 between Basin and VLC re CW65); (Ex. 121 (12/26/2007 Agreement between Basin  
23 and WSS re EVWD); Holder, Trial Tr. at 1479:18-25, 1482:7-15.) The prices for the sales were  
24 also determinable based on the terms of the letter agreements and a present value calculation of the  
25 taxes and insurance costs. (Tekulve, Trial Tr. at 209:17-210:5; Holder, Trial Tr. at 1481:4-9,  
26 1482:7-15.) There was also sufficient evidence to conclude that collectability from WSS was  
27 reasonably assured based on the financing provided by NCEC, which had done business with  
28 Basin in the past. (Holder, Trial Tr. at 1481:10-12; Tekulve, Trial Tr. at 298:12-15.) Collectability

1 from VLC was reasonably assured based on its financing agreement with CCH and the stand-by  
2 fees it would receive from municipalities. (Holder, Trial Tr. at 1471:24-1472:12; Tekulve, Trial  
3 Tr. at 319:19-25.)

4 The accounting for the WSS and second VLC transactions was incorrect because of  
5 Basin's failure to apply FIN 46R. For the same reasons articulated in connection with the first  
6 VLC transaction, however, Tekulve's failure to apply FIN 46R did not result from any lack of  
7 diligence or professional care.

8 Tekulve reasonably relied on Singer's professional advice in deciding to recognize revenue  
9 from these transactions. (Holder, Trial Tr. at 1482:4-15; Tekulve, Trial Tr. at 1344:13-20.) Singer  
10 performed an extensive review of the initial VLC transaction and the later transactions with WSS  
11 and VLC were explicitly modeled after that deal. Singer also contacted Litt and Ward to verify the  
12 structure of the WSS transactions. (Ex. 895 (Singer WP re WSS transaction).) Singer raised no  
13 concerns about the accounting for these transactions to Basin's audit committee and issued an  
14 unqualified report for the third quarter of 2007 and a clean audit opinion for Basin's 2007 year-end  
15 financial statements. (Exh. 236 at bates 3247; (Ex. 1469 (2007 audit report); Gupta, Trial Tr. at  
16 1405:7-23). No one at Basin misled Singer about these transactions or failed to provide requested  
17 information. (Tekulve, Trial Tr. at 1349:5-25; Ward-Cline, Trial Tr. at 1272:1-12.) Tekulve did  
18 not negligently, recklessly or fraudulently record revenue on the WSS or the second VLC  
19 transaction.

### 20 **3. Findings of Fact Relating to Insider Trading Allegations**

21 The SEC's insider trading allegations are based on two theories: 1) Jensen impermissibly  
22 traded during black-out periods and 2) Jensen traded while possessing the material non-public  
23 information that Basin's financial statements were fraudulent. The SEC introduced no evidence  
24 showing that Jensen traded on inside information other than his alleged knowledge of the  
25 supposed fraud.

26 Jensen did authorize the sale of approximately 882,000 shares on August 7, 2008 – three  
27 days before the Company announced that it might restate certain financial statements. (Florin,  
28 Trial Tr. at 788:3-15, 802:25-803:8; Ex. 595 (Albert Fried Account Statement 8/1/2008) at SEC-

1 LA3478-00009727.) However, in testimony elicited by the SEC, Marc Florin, the Jensens' broker,  
2 confirmed that he initiated the phone call on August 7 informing Jensen that a buyer was  
3 interested in purchasing a large amount of Basin stock. (Florin, Trial Tr. at 788:3-15.) Florin  
4 further testified that Jensen had not expressed any urgency to sell Basin stock in the days before  
5 the August 7 phone call (or at any time, for that matter). (Florin, Trial Tr. at 803:21-804:10,  
6 802:14-20). Florin testified that Jensen agreed with Florin's strategy, proposed in June 2008, to  
7 sell Basin stock in small enough increments so as to not harm the market for the stock. (Florin,  
8 Trial Tr. at 802:4-24.) Florin's testimony thus contradicts any argument by the SEC that Mr.  
9 Jensen had advance warning of the August 11, 2008 Press Release. Certainly, no witness so  
10 testified.

11 The SEC also argued at trial that Jensen's trades in the spring and summer of 2008 were  
12 improper because they occurred during black-out periods – periods where insiders of Basin were  
13 prohibited from trading stock – and that Jensen somehow remained an insider of Basin during this  
14 period. First, there is no charge in the Complaint that Jensen violated the securities law by trading  
15 during “black-out” periods. Second, the charge is also unfounded. Jensen resigned as CEO in  
16 February 2008, and resigned from the Board in March 2008. (Final Pretrial Conf. Order (Doc. No.  
17 193), ¶5.a. at 4.) A “Termination and Consulting Agreement,” executed in March 2008, makes  
18 plain that Jensen is no longer an employee of the company. (Ex. 971 (Employment Transition and  
19 Consulting Agreement); see also Solar, Trial Tr. at 1181:20-22; Gupta, Trial Tr. at 1425:25-  
20 1426:20.) Thus, under no theory was Mr. or Mrs. Jensen an “insider” of the company during this  
21 time. Finally, a letter authored by Scott Hamilton, the former SEC enforcement attorney who was  
22 at the time Basin's General Counsel, approved the removal of restrictive legends from the Jensens'  
23 stock and referred to the Jensens as “Selling Shareholders, and confirmed that they were not  
24 “affiliates” of Basin. (Ex. 592 (E-mail attaching 7/10/2008 Letter from S. Hamilton) at  
25 AFC00506.) As Solar testified, the only reason to remove restrictive legends is to sell shares.  
26 (Solar, Trial Tr. at 1186:2-12.) It makes no sense that Basin's General Counsel would approve the  
27 Jensens' sale of shares and acknowledge that they were not affiliates and were “Selling  
28 Shareholders,” if Jensen was prohibited from selling shares.

1 The SEC also suggested that Mr. and Mrs. Jensen's sales of Basin stock in 2007 through a  
 2 10b5-1 plan were also improper because some of those sales occurred during a "black-out"  
 3 periods. However, the plan itself contains no such restrictions. (Ex. 969 (Jensens' 10b5-1 Plan);  
 4 Solar, Trial Tr. at 1162:5-1164:7; Gupta, Trial Tr. at 1415:8-15.) The SEC never provided any  
 5 evidence to contradict the plain language of the plan or Jensen's understanding of that plan.

6 Other evidence contradicts an inference of scienter. Mr. and Mrs. Jensen first sold shares in  
 7 December 2006, and then only a small amount (50,000 shares out of 2.7 million shares owned).  
 8 (Ex. 1024 (2/15/2008 Basin Form 13D/A) at SEC-LA3478-00006502 (Mr. and Mrs. Jensen each  
 9 sold 25,000 shares); Ex. 1023 (5/15/06 Form S-8) at SEC-LA3478-00006192 (2,777,857 shares  
 10 owned by Jensens at IPO).)

11 Thereafter, Mr. and Mrs. Jensen placed 200,000 shares each into their 10b5-1 plan, which  
 12 remained in effect, unmodified, throughout Jensen's tenure at Basin. (Ex. 969 (Jensens' 10b5-1  
 13 Plan); Gupta, Trial Tr. at 1416:6-11.) While Mr. and Mrs. Jensen worked at Basin, the remainder  
 14 of their sales were pursuant to the 10b5-1 plan. (Final Pretrial Conf. Order (Doc. No. 193), ¶5(a) at  
 15 4 (Jensen resigned in March 2008), ¶6(a) at 7-8 (listing dates of trades and accounts); Jensen, Trial  
 16 Tr. at 922:2-13; Exs. 1033 and 1034 (2006-2008 Cannacord records).) All of the sales pursuant to  
 17 the 10b5-1 plan occurred between February and July of 2007. (*Id.*) Mr. and Mrs. Jensen did not  
 18 sell any of their respective remaining shares until after they resigned from Basin. (*Id.*; see also  
 19 Exs. 1033, 1035-1039 (2008 Charles Schwab records); Exs. 593-595, 598, and 600 (2008 Albert  
 20 Fried records).)

21 The evidence showed that when Jensen sold shares from May to August 2008 – after he  
 22 resigned from Basin – he did so with the full knowledge of Basin's Board, General Counsel and  
 23 outside securities counsel. (Solar, Trial Tr. at 1179:5-16, 1182:17-22; 1186:2-12; Tekulve, Trial  
 24 Tr. at 1351:25-1352:12, 1352:22-1353:18; Gupta, Trial Tr. at 1421:15-1422:6, 1433:25-1434:25;  
 25 Ex. 592 (E-mail attaching 7/10/2008 Letter from S. Hamilton) at AFC00506).) Jensen made plain  
 26 that one of the reasons he was resigning from Basin was so that he could sell shares, and use the  
 27 proceeds for the Empire Water project. (Tekulve, Trial Tr. at 1351:25-1352:12; see also Jensen,  
 28 Trial Tr. at 982:19-983:1.) No one told Jensen that he couldn't sell his shares. (Jensen, Trial Tr. at

1 983:23-984:2; Gupta, Trial Tr. at 1421:10-1425:19; see also Solar, Trial Tr. at 1185:17-1186:21.)

2 The defense also established that of the 2,777,857 shares owned by the Jensens at the time  
3 of the IPO, 1,320,000 were owned by Lorena Jensen as her sole and separate property. (Solar,  
4 Trial Tr. at 1140:16-1142:7, 1149:10-16; Ex. 1023 (5/15/06 Form S-8) at SEC-LA3478 00006192;  
5 Jensen, Trial Tr. at 915:21-916:2 and 917:5-11; Ex. 1184 (9/20/05 Agreement for Transfer of  
6 Stock), ¶¶ 2-3 at 1184- 1 to 1184-2.) As Florin testified in the SEC's case in chief, the Jensens  
7 sold their shares in equal amounts when executing sales. (Florin, Trial Tr. at 801:19-25.) Thus  
8 48% of the sales put at issue in the Complaint (1.3/2.7) were in fact sales by Mrs. Jensen of her  
9 sole and separate property.

#### 10 **4. Nature of Jensen and Tekulve's Compensation**

11 For many years, neither Mr. nor Mrs. Jensen took any salary from the Company. (Solar,  
12 Trial Tr. at 1146:1-14, 1148:6-8.) When Jensen did begin receiving salary, it was well below  
13 market. (Solar, Trial Tr. at 1148:9-13.) At the time of the incorporation of the Company, Jensen  
14 received 950,000 in shares in the Company, or 95% of the outstanding stock. (Solar, Trial Tr. at  
15 1147:8-17; Exhibit 1645 (First Actions of Basin Board of Directors) at 1645-3.) This stock was  
16 earned by Jensen, both for his role as the founder and leader of the Company, and as compensation  
17 for his work. (*Id.* at 1147:12-23.) In addition, Jensen donated his patents on ion-exchange to the  
18 Company (*Id.* at 1146:18-1147:1.)

19 The SEC elicited no testimony that Jensen received incentive-based compensation in 2006  
20 and 2007. The evidence was to the contrary. (Solar, Trial Tr. at 1201:5-1202:1.) To the extent that  
21 Jensen "profited" from the sale of stock, this was stock he received upon founding the company in  
22 1999. (Solar, Trial Tr. at 1147:12-17; see also Jensen, Trial Tr. at 915:21-916:13.)

23 Tekulve did not profit from Basin's decision to recognize revenue on any of the disputed  
24 transactions. Neither his salary nor his bonuses were linked to Basin's revenue or stock price.  
25 (Solar, Trial Tr. at 1196:17-1197:9, 1201:20-1202:1; Ex. 558 (3/22/07 Compensation Minutes) at  
26 3; Ex. 559 (12/28/07 Compensation Minutes) at 7; Final Pretrial Conf. Order (Doc. No. 193),  
27 ¶5(d) at 5.)

28 Tekulve's first bonus of \$100,000 in March 2007 was awarded in recognition of his efforts

1 in preparing Basin's initial public offering. (Solar, Trial Tr. at 1196:17-1197:9 and Ex. 558  
2 (3/22/07 Compensation Minutes) at 3; Final Pretrial Conf. Order (Doc. No. 193), ¶5(d) at 5.)

3 His \$50,000 year-end bonus for 2007 was granted as part of an unstructured incentive  
4 program that was not tied to financial targets. (Ex. 559 (12/28/07 Compensation Minutes) at 7;  
5 Solar, Trial Tr. at 1201:20-1202:1.)

6 While Tekulve received a significant portion of his compensation in Basin stock and stock  
7 options, Tekulve sold none of his Basin stock until after the restatement and his departure from the  
8 company. (Tekulve, Trial Tr. at 1348:18-22.) The proceeds of those sales totaled \$1,200.  
9 (Tekulve, Trial Tr. at 1348:18-1349:2.)

#### 10 **5. Basin's Restatement**

11 In May 2008, Stark demoted Tekulve and replaced him with Chris Chisholm, who had  
12 served as Stark's CFO at a prior company. (Stark, Trial Tr. at 687:16-23.) After Chisholm started  
13 at Basin, he investigated certain transactions from 2006 and 2007. (Stark, Trial Tr. at 687:24  
14 688:3.) He asked that an ongoing Audit Committee investigation led by the law firm of Drinker  
15 Biddle be expanded to include review of those transactions. (Stark, Trial Tr. at 688:6-9.)

16 On October 28, 2008 Basin's Audit Committee met to hear a report from Drinker Biddle  
17 regarding the results of the internal investigation. The investigation included review of all of the  
18 transactions at issue in this litigation, in addition to others. (Ex. 853 (10/28 and 10/29/08 Audit  
19 Minutes.) The Audit Committee concluded that there was no evidence of fraud. (Fryling, Trial Tr.  
20 at 1387:16-19, 1398:22-1399:5; see also Ex. 583 (10/29/08 Minutes) at SEC-LA3478-01230505  
21 and 01230509; see also Stark, Trial Tr. at 689:12-691:3.)

22 Basin decided to restate its 2006 and 2007 financial results, including the transactions at  
23 issue in this case. Basin retained Singer as the auditor for the restatement. On February 10, 2009,  
24 Basin filed restated financial statements for 2006 and 2007. (Ex. 845 (Form 10K-A).) As part of  
25 their audit of the restated financial statements, Singer specifically determined that the transactions  
26 at issue here were not being restated as a result of fraud. (Ex. 851 (Basin Water, Inc. Memo on  
27 Fraud 2006 and 2007); Ex. 873 (Basin Water, Inc. SL Memo of Restatement Transactions of 2006  
28 & 2007 Audit and Q1 2008 Review); Fryling, Trial Tr. at 1387:16-19, 1398:22-1399:5; Solar,



1 Trial Tr. at 1189:19-22; Ex. 851 (Singer Memo on Fraud) at SEC-LA3478-1272322, 1272324,  
2 1272326 (“Fraud consideration: No”).)

3 In March 2009, Latham responded on Basin’s behalf to a comment letter from the SEC  
4 about the restatement. (Ex. 1166 (3/30/09 Comment Letter).) The SEC comment letter asked  
5 specifically why the VLC and WSS transactions had been restated. Basin’s response was reviewed  
6 by Basin senior management and Singer before it was provided to the SEC. (Ex. 1165 (3/26/2009  
7 E-mail from S. Hamilton to C. Chisholm, D. Gupta, G. Moore, I. Lawson, and D. Hansen Re:  
8 “Revised Response to SEC Comment Letter”).) The letter noted that “FIN 46(R) is a complex  
9 standard that [Basin] had not previously had occasion to apply.” (Ex. 1166 at 1166-8 (3/30/09  
10 Comment Letter).) The letter went on to state that the Basin personnel involved with the original  
11 accounting of the VLC and WSS transactions “lacked a sufficiently robust accounting  
12 background” to identify all relevant accounting issues with these transactions. (Ex. 1166 at 1166-8  
13 (3/30/09 Comment Letter).) Basin’s response to the SEC made no mention of fraud or intentional  
14 misconduct by Tekulve or Jensen, neither of whom worked at Basin at the time the response was  
15 written.

## 16 **II. Conclusions of Law**

### 17 ***A. Bench Trial was Appropriate***

18 The trial appropriately proceeded as a bench trial. The Complaint did not contain a request  
19 for a jury trial. Doc. no. 1. On August 1, 2011 Tekulve filed an answer that contained a request for  
20 a jury trial. Doc. no. 8. Also on August 1, 2011, defendant Jensen filed an answer that contained a  
21 request for a jury trial. Doc. no. 11. The SEC never requested a jury trial.

22 On March 29, 2013 Defendants filed a notice that they were waiving their right to a jury  
23 trial and consenting to a trial by the Court. Doc. no. 166. Also on March 29, 2013, the SEC filed a  
24 response to the defendants’ waiver, which argued that the Defendants’ notice should be  
25 “disregarded by the court.” Doc. no. 67.

26 The Court issued a minute order on April 1, 2013, which provided that:

27 The Court continues the Final Pre-Trial Conference to September 9, 2013 at 11:00  
28 a.m., and sets the matter for Court Trial (defendants having filed a waiver of trial  
by jury on March 29, 2013, and only the defendants timely requested a jury trial)

1 on October 15, 2013 at 9:00 a.m.

2 The SEC did not file a motion asking the court to reconsider this order and did not  
 3 otherwise object to it until doing so in the proposed pre-trial order filed on September 5, 2013.  
 4 Doc. no. 190. A party's failure to object to an order scheduling a non-jury trial may be treated as a  
 5 waiver of that party's right to a jury trial. *Sewell v. Jefferson County Fiscal Court*, 863 F.2d 461,  
 6 465 (6th Cir. 1988). The SEC's failure to object to the April 1, 2013 order in any way until  
 7 September 5, 2013 constituted such a waiver. In the proposed pre-trial order, Defendants stated  
 8 that they relied on the Court's April 1, 2013 order—and the SEC's lack of objection to that  
 9 order—in preparing for a bench trial after the order was issued. This reliance of Defendants, the  
 10 substantial amount of time between the issuance of the April 1, 2013 order and any objection by  
 11 the SEC, and the fact that the SEC never requested a jury trial means that the SEC waived any  
 12 right to a jury trial it may have had.

13 ***B. Analysis of the Causes of Action in the Complaint***

14 The Complaint contains seven causes of action. Summary judgment was granted in favor  
 15 of Defendants on the sixth cause of action. Doc. no. 109. This left causes of action one, two, three,  
 16 four, five, and seven to be tried. It was the burden of the SEC to establish at trial, by a  
 17 preponderance of the evidence, that Defendants violated the law as alleged in the Complaint.  
 18 *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 (1983).

19 **1. First Cause of Action: Violation of Section 17(a) of the Securities Act**

20 The SEC alleges that Defendants violated all three subsections of Section 17(a).  
 21 Section 17(a) provides that:

22 It shall be unlawful for any person in the offer or sale of any securities . . . (1) to  
 23 employ any device, scheme, or artifice to defraud, or (2) to obtain money or  
 24 property by means of any untrue statement of a material fact or any omission to  
 25 state a material fact necessary in order to make the statements made, in light of the  
 26 circumstances under which they were made, not misleading; or (3) to engage in any  
 transaction, practice, or course of business which operates or would operate as a  
 fraud or deceit upon the purchaser.

27 Title 15 U.S.C. § 77q(a).

28 Section 17(a)(1) "proscribe[s] only knowing or intentional misconduct." *Aaron v. SEC*,

1 446 U.S. 680, 696 (1980). In other words, a finding of liability under Section 17(a)(1) requires a  
 2 finding of scienter. *SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 856 (9th Cir. 2001). Along with  
 3 intentional misconduct, the scienter requirement can also be met by a showing of recklessness. *Id.*  
 4 Recklessness is defined as “conduct that consists of a highly unreasonable act, or omission, that is  
 5 an extreme departure from the standards of ordinary care, and which presents a danger of  
 6 misleading buyers or sellers that is either known to the defendant or is so obvious that the actor  
 7 must have been aware of it.” *Id.*

8 Sections 17(a)(2) and (3) consist of a negligence standard, which requires a showing that  
 9 the defendant acted without reasonable prudence. *Id.* at 857.

10 Leading up to the trial, the SEC’s position was that the six transactions were shams. *See,*  
 11 *e.g.*, SEC’s Trial Brief, Doc. no. 196 (stating that Defendants engaged “in a two-year scheme to  
 12 record phony revenues from sham transactions purportedly engaged in by Basin Water, Inc.”). No  
 13 documentary evidence or witness testimony presented at the trial tended to show that any of the  
 14 transactions were shams. In fact, everybody involved in the various transactions testified that they  
 15 were actual, legitimate deals.

16 Apparently recognizing this, the SEC now concedes that these transactions were legitimate  
 17 and argues that scienter is present because Defendants recognized revenue in ways that were either  
 18 in contravention of GAAP and/or misleading because revenue was recognized on transactions that  
 19 “had no economic substance.” SEC’s Proposed Findings of Fact and Conclusions of Law, Doc.  
 20 no. 216, p. 124. As recounted above, the evidence does not support the SEC’s position because  
 21 revenue was properly recognized on all six transactions in accordance with GAAP and the  
 22 transactions had economic substance.

23 The SEC’s entire case essentially rests on allegations of improper accounting. The only  
 24 evidence that supports the SEC’s position in this regards is the testimony of Professor Carla Hayn.  
 25 As discussed above, the Court does not find Professor Hayn’s testimony to be persuasive. The  
 26 Court does find the opinion of Professor William Holder to be persuasive.

27 Further under-cutting the SEC’s position is the fact that the case-law recognizes that “[t]he  
 28 provisions of GAAP are subject to interpretation.” *In re Fannie Mae 2008 Sec. Litig.*, 742

1 F.Supp.2d 382, 408 (S.D.N.Y. 2010). “Financial accounting, in short, is hospitable to estimates,  
2 probabilities, and reasonable certainties.” *Thor Power Tool Co. v. C.I.R.*, 439 U.S. 522, 543  
3 (1979). “Accountants long have recognized that generally accepted accounting principles are far  
4 from being a canonical set of rules that will ensure identical accounting treatment of identical  
5 transactions. Generally accepted accounting principles, rather, tolerate a range or reasonable  
6 treatments, leaving the choice among alternatives to management.” *Id.* at 544.

7 Revenue on the various transactions was recognized in a way that was not consistent with  
8 Professor Hayn’s interpretation of GAAP. However, as discussed above, the Court gives very  
9 little weight to Professor Hayn’s opinion because of her excessive reliance on hindsight (among  
10 other deficiencies in her methodology). In the opinion of everybody who viewed the transactions  
11 without the benefit of hindsight, revenue recognition was consistent with GAAP. This includes  
12 Professor Holder, as well as the individuals who analyzed the transactions concomitantly with the  
13 revenue being recognized; namely Basin’s auditors, Board of Directors, and, in certain cases when  
14 they were asked to opine, Basin’s outside and general counsel. The revenue recognition at issue in  
15 this case was within the range of reasonable treatment and therefore consistent with GAAP. *Thor*  
16 *Power Tool Co.*, 439 U.S. at 544.

17 The argument that the transactions lacked economic substance is similarly without merit.  
18 As recounted above, there were valid economic justifications for all six of the transactions.

19 The SEC has not presented any direct evidence that Jensen of Tekulve knowingly or  
20 intentionally mislead anybody. The SEC’s position that scienter can be inferred from  
21 circumstantial evidence is also not persuasive. There is also no evidence of recklessness, as the  
22 Defendants’ conduct was not an extreme departure from the standard of ordinary care. *Dain*  
23 *Rauscher*, 254 F.3d at 856.

24 Finally, the evidence shows that Defendants did not act negligently. They had in place  
25 several levels of internal and external review, and thoroughly vetted all the transactions at issue in  
26 this case before deciding to record revenue on those transactions. The evidence shows that  
27 Tekulve personally worked diligently on ensuring that he got the accounting right. This included  
28 his reasonable reliance on the advice of the numerous professionals working both inside and

1 outside Basin. As for Jensen, the evidence shows that he was not familiar with accounting and he  
2 reasonably relied on professionals who were familiar with it to generate Basin's financial reports.

3 The evidence does not support a finding that Defendants violated Section 17(a).

4 **2. Second Cause of Action: Violation of Section 10(b) of the Exchange Act as**  
5 **Primary Violators and Control Persons**

6 Rule 10b-5, which is promulgated by the SEC pursuant to its authority under Title 15  
7 U.S.C. § 78j, provides that:

8 It shall be unlawful for any person, directly or indirectly, by the use of any means  
9 or instrumentality of interstate commerce, or of the mails or of any facility of any  
10 national securities exchange,

11 (a) To employ any device, scheme, or artifice to defraud,

12 (b) To make any untrue statement of a material fact or to omit to state a material  
13 fact necessary in order to make the statements made, in the light of the  
14 circumstances under which they were made, not misleading, or

15 (c) To engage in any act, practice, or course of business which operates or would  
16 operate as a fraud or deceit upon any person, in connection with the purchase or  
17 sale of any security.

18 17 C.F.R. § 240.10b-5.

19 To establish a violation of Rule 10b-5 a showing of scienter is required. *Ernst & Ernst v.*  
20 *Hochfelder*, 425 U.S. 185, 193 (1976).

21 In addition to alleging that Defendants each individually violated Rule 10b-5, the SEC  
22 alleges that Defendants are liable as control persons under Section 20(a). To establish a violation  
23 of Section 20(a), a showing must be made that "(1) there is a violation of the [Securities] Act and  
24 (2) the defendant directly or indirectly controls the person liable for the violation." *SEC v. Todd*,  
25 642 F.3d 1207, 1223 (9th Cir. 2011).

26 As discussed above, Defendants did not act with scienter with respect to the allegations of  
27 improper revenue recognition. Therefore they are not liable under Rule 10b-5 with respect to those  
28 allegations. There is also no evidence that Basin itself or anybody else working at Basin violated  
any securities laws. As no violations of the securities laws took place, there can be no control  
person liability. *Todd*, 642 F.3d at 1223.

The SEC also alleges that Jensen violated 10b-5 with respect to his sale of Basin stock. As  
set out above, no evidence was presented showing that Jensen possessed material non-public

1 information when he traded. *United States v. O'Hagan*, 521 U.S. 642, 651 (1997). Furthermore,  
2 after he left the company he was not subject to the black-out periods. The SEC's allegations that  
3 Jensen's knowledge of the fraudulent scheme constitutes material non-public information are  
4 without merit because the evidence does not support a finding that there was fraudulent scheme.  
5 There is also no evidence that Jensen knew the restatement was going to be issued when he sold  
6 his stock.

### 7 **3. Third Cause of Action: Issuer Reporting Violations Under Section 13(a)**

8 Section 13(a) requires a company to file "financial statements that (1) are prepared in  
9 conformity with GAAP; and (2) contain a report by an independent auditor certifying that the  
10 auditor had audited the company's financial statements . . . to determine whether the statements  
11 were prepared in accordance with GAAP." *Ponce v. SEC*, 345 F.3d 722, 735 (9th Cir. 2003). The  
12 company also has a duty to "correct any misstatements or omissions the documents filed with the  
13 SEC" and the documents must have enough information to prevent them from being misleading.  
14 *Id.*

15 Individuals are liable for a company's violation of Section 13(a) if the individual (1)  
16 willfully aided and abetted the violation or (2) was a control person. Title 15 U.S.C. § 78t.

17 A finding of aiding and abetting liability premised on a primary violation of Section 13(a)  
18 requires a showing that (1) a primary violation occurred; (2) the individual knew about the  
19 violation and his or her own role in furthering that violation; and (3) the individual substantially  
20 assisted in the primary violation. *Ponce*, 345 F.3d at 737.

21 A finding of control person liability premised on a primary violation of Section 13(a)  
22 requires a showing that (1) a violation of Section 13(a) occurred and (2) the defendant directly or  
23 indirectly controls the company or individual responsible for the violation. *SEC v. Todd*, 642 F.3d  
24 1207, 1223 (9th Cir. 2011).

25 The evidence does not support this claim because the financial statements at issue were  
26 prepared in conformance with GAAP and contained the required certification.

27 ///

28 ///

1                   **4. Fourth Cause of Action: Record-Keeping Violations under Section 13(b)(5)**

2                   Section 13(b)(5) provides that “no person shall knowingly circumvent or knowingly fail to  
3 implement a system of internal accounting controls or knowingly falsify any book, record, or  
4 account . . . .” Title 15 U.S.C. § 78m(b)(5). Scierter is a required element under Section 13(b)(5).  
5 *SEC v. Retail Pro, Inc.*, 673 F.Supp.2d 1108, 1141 (S.D. Cal. 2009). The SEC alleges that  
6 Defendants are liable under Section 13(b)(5) because they falsified the books, records, and  
7 accounts of Basin.

8                   As discussed above, the evidence does not support a claim that Defendants falsified any  
9 financial statements or other books, records, or accounts of Basin. Also, the evidence shows that  
10 Defendants had in place an adequate system of internal accounting controls. There is therefore  
11 insufficient evidence to support this claim.

12                   **5. Fifth Cause of Action: Misrepresentations to Accountants (against Tekulve**  
13                   **only)**

14                   The SEC alleges that Tekulve is liable under Section 13(b)(5) because he mislead Basin’s  
15 accountants by either misstating information or failing to inform the accountants of material  
16 information. 17 C.F.R. § 240.13b2-2. The evidence presented at trial shows that Tekulve gave  
17 accurate and complete information to Basin’s outside accountants, Singer. Tekulve worked closely  
18 with Singer to ensure that he was properly accounting for the various transactions.

19                   Notably, the SEC did not call any witnesses from Singer.

20                   **6. Seventh Cause of Action: Failure to Reimburse Pursuant to Section 304 of**  
21                   **the Sarbanes-Oxley Act**

22                   Title 15 U.S.C. § 7243 specifies that if “an issuer is required to prepare an accounting  
23 restatement due to the material noncompliance of the issuer, as a result of misconduct” the CEO  
24 and CFO must reimburse the issuing company for “any bonus or other incentive-based or equity-  
25 based compensation” or “any profits realized from the sale of securities.” Reimbursement is only  
26 required if the compensation or stock sale profits were received “during the 12-month period  
27 following the first public issuance or filing with the Commission (whichever first occurs) of the  
28 financial document embodying such financial reporting requirement.” Title 15 U.S.C. § 7243.



1 Basin's restatement was not issued due to any misconduct on the part of Defendants. As  
2 discussed above, Defendants did not act with scienter or negligence in preparing the financial  
3 documents that were restated. Additionally, Singer specifically found that the restatement was not  
4 necessitated by any fraud and Basin's Board of Directors never made a determination that the  
5 restatement was required due to misconduct by Jensen or Tekulve. Solar, Trial Tr. at 1189:19-22.

6 **III. Conclusion**

7 The SEC has not carried its burden of proof with respect to any of the causes of action in  
8 the Complaint.

9 **IT IS HEREBY ORDERED** that judgment is to be entered for Defendants on all causes  
10 of action in the Complaint.

11 Dated: December 10, 2013.

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14 MANUEL L. REAL  
15 UNITED STATES DISTRICT JUDGE  
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